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NATIONAL ASSOCIATION OF SECURITIES DEALERS
CASE NO. 04-02723
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In the Matter of the Arbitration
-between-
AMERICAN EXPRESS FINANCIAL ADVISORS,
Claimant,
-and-
FRANK PATRICK MARZANO,
Respondent.
---x

NASD
One Liberty Plaza
New York, New York
December 5, 2005, 9:10 a.m.

B E F O R E: MARTIN HUNGER, Chairman
ROBERT COHEN, Arbitrator
STEVEN J. PETRIE, Arbitrator

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ALSO PRESENT:

ROBERT M. LEVINE, CM
Court Reporter

THE CHAIRMAN: On the record. Good morning, gentlemen.

For the record, this is a continuation of NASD arbitration 04-2723, American Express Financial Advisors against Frank Patrick Marzano. This is session number 23, I believe. And present in the room are on behalf of American Express?

MR. ZARETSKY: Michael Zaretsky.

MR. GOOD: Eliot Good.

THE WITNESS: Owen Dahl.

THE CHAIRMAN: On behalf of Mr. Marzano?

MR. MARZANO: Frank Marzano.

MR. CAMPBELL: And Tom Campbell.

THE CHAIRMAN: And you the panel, Mr. Petrie and Mr. Cohen and Mr. Hunger are all present.

Ready to proceed?

MR. GOOD: Yes.

THE CHAIRMAN: Mr. Good, I believe you you had Mr. --

THE WITNESS: Dahl.

THE CHAIRMAN: -- Dahl as your witness.

Mr. Dahl, just remind you, I'm sure it's not necessary, but you're still under oath.

THE WITNESS: Thank you.

DIRECT EXAMINATION (cont'd)
BY MR. GOOD:

Q. Mr. Dahl, do you have an opinion regarding whether the least square regression analysis performed and presented by Mr. Marzano was correct?

A. Yes, I do.

Q. What is that opinion?

A. My opinion is that it's incorrect.

Q. What is the basis for that opinion?

A. The first and primary basis for the opinion is that the analysis of a shortened period of time and a forecast based on a 14-month period of time did not adequately capture the factors that affect assets under management for Mr. Marzano or any rep, particularly given the 14-month period that was used.

MR. GOOD: You need to keep your voice up so the panel can hear you.

THE WITNESS: Absolutely.

Q. Say that again, please.

A. My opinion is that the 14-month period of time that was used to project the future in this case is too dissimilar from what actually occurred and what we would expect to occur on its own to receive any merit.

Q. Explain that, please.

A. Sure. The first and primary reason that there's a significant overforecasting of assets under management during the period in time that the stock market between the period December 2003 to February 2004 -- exuse me -- December 2002 and February 2004 which form the basis for the forecasting period was a period of extremely strong asset growth. The average market indexes, the NASDAQ, the S&P, the Dow, the Russell 1000, all rose on average by slightly less than 40 percent on an annual basis.

Q. Let me stop you right there.

A. Sure.

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Q. When you talk about an "overforecasting of assets," in order to determine that and to use that phrase, what did you do?

A. What we did is looked back at the stock market indexes during the period in time in question. And looked to see how the supermarkets performed. We also looked, particularly since we last spoke, at Mr. Marzano's actual asset mix; that is, his equity assets and his fixed income assets to understand how these very strong stock market returns would have affected his performance in terms of asset under management growth.

Q. In evaluating Mr. Marzano's actual asset mix, what did you determine?

A. What we determined was that Mr. Marzano is right at 60 percent equity, 40 percent fixed income. And in the fixed income product we included all annuities, including variable annuities and money market products as well. And just, that's not exactly accurate because obviously annuities, variable annuities have an equity component to them. But

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particularly, for sake of being conservative, we felt it was necessary to include them there.

Q. Now, what effect did the actual asset mix have on your opinion relative to the shortened period of time?

A. What we found is that, given that asset mix, given the equity and bond markets during the period of time in question, that Mr. Marzano's assets rose purely from market returns by a rate of 26.6 percent.

Q. And that would be 26.6 percent with no new money being placed into the equation?

A. That's exactly right.

Q. Now, what period of time was it that the market performed slightly less than 40 percent?

A. Between February 2003 and February 2004, in particular. But December 2002 to February 2004, the specific time frame --

MR. CAMPBELL: I'm sorry. You say December 2003?

THE WITNESS: December 2002.

MR. CAMPBELL: Okay.

Q. After that period of time, how did

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the market perform?

A. Actually, the market has been best characterized all the way through the end of October as a sideways market. Market returns were about 6 percent from the period February 2004 to October 2005. It's only actually in the months of November, late in the month of November that the stock market has surpassed the February 29th number consistently.

Q. The February what number?

A. The February 2004, February 29, 2004 -- would it be of assistance to visually show these numbers?

Q. I think it would be.

Did you prepare something to that effect?

A. I did. I prepared a worksheet that shows all of the indexes at set periods of time, including February 2003, February 2004, February 2005 and October 31, 2005.

Q. Is that it?

A. Yes. This is it.

MR. GOOD: Mr. Chairman, for purposes of examination and for

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identification purposes may, I hand to you Exhibit 1 which is entitled, "AEFA/Marzano Historical Asset Analysis."

THE CHAIRMAN: I'm not sure it's Exhibit 1.

MR. GOOD: I'm sorry.

ARBITRATOR PETRIE: Claimant's 11 for identification.

MR. GOOD: 11. I apologize.

(Document entitled, "AEFA/Marzano Historical Asset Analysis" marked Claimant's Exhibit 11 for identification as of this date.)

MR. CAMPBELL: I don't know what he's talking about, Mr. Chairman. I haven't seen it and I don't have it now.

MR. GOOD: I will be happy to provide it to you right now.

THE CHAIRMAN: Mr. Campbell, do you want to take a few-minute break?

MR. CAMPBELL: I don't think a short break would help us very much, Mr. Chairman. As I said, I haven't seen the exhibit before. And we'll just have to

wait and you see what the witness has to say about it.

THE CHAIRMAN: Just wondering if you need a few minutes by yourself. If not, Mr. Good, you want to continue?

MR. GOOD: Thank you.

Q. Mr. Dahl, would you walk me through this analysis, please.

A. Sure. The first box at the top of this exhibit shows some commonly referred to, commonly used equity index data, including the Dow, the NASDAQ, S&P 500 and Russell 1000.

Q. Why did you select those?

A. Those are four commonly used. Particularly the S&P 500, the Russell 1000 is a broad market index. They tend to capture a significant basket of this economy.

The Dow and the NASDAQ at the top tend to be a little more specialized. The Dow is a large cap index. The NASDAQ is a very broad index as well, but has a lot of assorted tech, energy, et cetera, products in there. So by looking at sort of a broader index set we wanted to make sure we weren't picking on, if

you will, a single index and using it incorrectly.

What you can see, particularly in terms of annual growth rates, is that the period February 2003 to February 2004 corresponds across the board with these index very, very strong equity returns. The NASDAQ is at 51 percent. The other three are very close; between 34 and 37 percent annual returns.

Q. Let me stop you there for a moment.

A. Okay.

Q. Earlier you talked about a shortened period of time for evaluation of the information.

A. Right.

Q. What's significant about that shortened period of time as to this annual growth rate?

A. When a regression analysis or any comparative analysis is based on shortened period of time, you run the risk that there are variables within that set of data that don't reasonably support the future.

In this case, it's clear, I think,

that equity returns in the high 30s on a consistent annual basis are not appropriate. And, in fact, as you look forward to the next 12-month period it's clear that's not what happened.

In other words, the asset growth going forward the next 12 months on Mr. Marzano's book of business was nowhere near the 39.9 percent equity or the 26.6 percent blended rate.

Q. How does that affect the evaluation; the calculation that Mr. Marzano presented to the panel?

A. He would end up, if not adjusting for it, he would end up overcomputing his estimated damages by overcomputing the expected assets under management at any future given time.

Q. When you reviewed his calculation, did he take into account a change in the equity rate of return?

A. No. As a matter of fact, implicit in his regression analysis is that stock market returns will continue at 39.9 percent

indefinitely.

Q. How do you know that?

A. Because it's a factor. The growth in assets is a factor that is incorporated in the assets under management number that he uses to forecast off of.

In other words, as his assets monthly change, part of that asset mix that he's computing his future growth includes these extremely high stock market returns.

Q. Let me take you back to the model itself that Mr. Marzano utilized.

A. Sure.

Q. Last week you indicated that the least square regressive analysis utilized by Mr. Marzano utilized only one variable.

A. That's right.

Q. And that variable was time?

A. Correct.

Q. Does that mean that the variable relative to rate of return was not factored into his equation?

A. That's exactly right.

Q. So there was an assumption that

turns out not to be correct in terms of the modeling of his damage calculation that affects the significance and the legitimacy of that number?

A. Yes. Unless that specific variable was considered, it is implicit in his analysis that those equity returns will continue in the future.

Q. We'll get to what a better way of doing that in a moment is.

A. Sure.

Q. Why don't you continue your evaluation.

A. As you move across that top box you can see a couple of periods. And these periods were chosen to correspond to this case in particular. The first box shows you the next 12 months for comparative purposes. And, as I said, you can see the stock market returns were virtually flat between the 28th of February 2005 and the 20th of February 2004. Average growth rate across the indices is about 3.4 percent.

Since February there has been some improvement in the stock markets. The average

rate of return on an annualized basis is about 6.6 percent. In no case since February of '04 and October 31, 2005, and indeed, today, have the stock market returns come anywhere near an annualized 39.9 percent.

Q. Now, let me bring you back to your concept of a time frame utilized that's too short.

A. Right.

Q. Is it more appropriate to have evaluated and utilized a least square regression analysis only when you've gone through a full business cycle?

A. It would have dramatically improved the model to look at a full business cycle.

Q. What is a full business cycle in this instance?

A. By definition, we typically think of a full business cycle as the bottom of a trough in a regression to the peak during an essential period.

Q. In light of the fact that Mr. Marzano may not have had these clients over a period of time of a full business cycle, how

should he have accounted for that in his modeling or in his forecasting?

A. The most important way, if you're going to stick with a regression model, what Mr. Marzano could have done to probably significantly improve the model would have been to also consider the implications or the effect of, for example, a stock market index on his assets under management.

In other words, to date, he's shown there to be one important relationship; that being a relationship of time to assets. It would have been an improvement for the model to actually regress or compare the assets under management with stock market returns. That would become a two-variable regression analysis.

Q. When you say that "becomes a two-variable analysis," that is not what Mr. Marzano did?

A. No. That is correct.

Q. What would you have had to have done to do that two-variable analysis?

A. If you recall, in Mr. Marzano's work papers his regression analysis was

developed by pairing assets under management with time for 14 separate periods.

Q. Okay.

A. To improve that, you would have added a third comparison. And that was assets under management, time, and, for example, the Standard & Poor's 500 index at the same point in time.

Q. Why the Standard & Poor's 500?

A. You could do it with the Russell. You can do it with the NASDAQ. You can do it with the Dow. I picked that, the Standard & Poor's 500, in this case, simply because it's often considered a reasonable proxy for a broad market index.

Q. Are you saying then that that takes into account the assets that grew on the basis of the market return versus the dollars, new dollars that clients have put into the equation?

A. Yes.

Q. Please go on with your analysis.

A. Okay. The second box, as you can see, is the same type of analysis. It's looking at a couple of, excuse me, commonly referred to

bond index, including the Dow Jones Corporate Bond Index and one that's often considered to be a good proxy for a broad index, the Lehman Aggregate Bond Index.

As you can see there, the annual rates of growth, 5.3 percent during the period of time at which Mr. Marzano's analysis was done, it's actually been lower too in terms of total returns since February of 2004. It was about 1.4 percent on average, those two indexes, during the next 12 months. And it's been virtually flat since February of 2004.

Q. What's the significance of that as to Mr. Marzano's modeling of his valuation?

A. As we mentioned previously, the assets under management of Mr. Marzano are roughly -- actually, I take that back. They're almost exactly split 60-40 between equity assets and fixed income assets.

So in order to understand the total return on Mr. Marzano's portfolio it's more appropriate to look at a weighted average of the two asset classes. So we pulled the bonding index to give us an idea as to what the returns

on the 40 percent of his assets under management were over this same period of time.

Q. Go on.

A. Box 3 is, we talked briefly about, as you can see the weighting of assets in Mr. Marzano's portfolio. That's column 1. The rates of return which come directly from above, this is a look effectively at the rate of return on his assets during the period of time the regression was run. And, as I mention, it's 26.1 percent.

The box below that looks at March 2004 through October 31, 2005. The same weightings with the returns on the market as calculated above. As you can see, the actual returns, what I've termed here to be organic growth, that being growth that does not come from new clients is about 4 percent or 22.1 percent lower than during the forecasting period.

Q. Now, you also indicated that you looked at Mr. Marzano's book of business.

A. Correct.

Q. For what period of time did you

look at his book of business?

A. We looked at statements as of February 2004. And we looked at summary data as of September 2005.

Q. Now, you said "we." Who is we?

A. I actually utilized two of my staff members, two analysts on my staff to compile the data.

Q. Under your direction?

A. Under my direction. Correct.

Q. What were your directions?

A. My directions were to take each statement, pull out the equity mutual funds, the fixed income products, leave all annuities in as fixed income products. Also, to give me an idea as to the magnitude of Class B shares, money market products, real estate, other investments.

Q. Did you have occasion to review that information?

A. I did.

Q. Did you have occasion to test that information?

A. I did test it as well.

Q. How did you test it?

A. I pulled randomly statements of approximately 25 of the 200. I believe there were 253 statements. And looked at them relative to the data inputs to ensure that they were done correctly.

We also by summing the dollar amounts felt that they were the same as the dollar amounts on the summary pages provided by American Express.

Q. Did you find that information to be accurate?

A. Yes.

Q. Now, in looking at that book of business and utilizing that book of business as to Mr. Marzano's calculation, any problem with how we calculated it based upon what you found in those statements?

A. There's no specific mathematical error in the formula that was provided by Mr. Marzano. As I mentioned before, the implications are not correct or cannot be reasonably expected going forward.

Q. The numbers that Mr. Marzano used, are those gross numbers?

A. Correct.

Q. What does that mean; that he utilized gross numbers?

A. Well, the problem with using gross assets under management and then gross dealer concessions is that there's not necessarily a linear, or otherwise an exact dollar-for-dollar relationship between revenues generated by a planner and take-home income. This is particularly the case as asset growth occurs and client growth occurs. And I don't have the data to properly test this. But it would have been more appropriate to focus on a bottom line or net income number, if you will.

Q. Why is that?

A. Different expense structures. As client growth occurs, you are not necessarily going to take home on a dollar-for-dollar basis every dollar that's earned in dealer concessions.

Q. Would splits of income with other representatives or advisors affect that gross dealer concession?

A. Very much so. Particularly if the

mix of assets under management changes between effectively 100 percent controlled by Mr. Marzano and a growth in secondary reps, if you will, who are taking on more and more of the book of business.

That it's reasonable as the client base grows and your ability to service the clients grows, you will end up paying more of those gross dealer concessions to your second and third representatives.

Q. And that would then affect and change the modeling that was presented by Mr. Marzano?

A. Yes.

ARBITRATOR COHEN: Can you clarify that for me? I followed you up until now. But I lost you.

How would a split of commissions or sales credits affect the return, if, in fact, the sales credit was X --

THE WITNESS: Right.

ARBITRATOR COHEN: -- and it was divided in half.

THE WITNESS: If I'm not mistaken, Mr. Marzano calculated his dealer concessions based on his historical experiences which includes payments to himself, and to the extent he has commissioned reps, payments to them as well.

As the assets under management increases, particularly an increase from 70 million to 127 million, that's being hypothecated.

ARBITRATOR COHEN: So what you're basically saying is that Mr. Marzano would have less of a payout?

THE WITNESS: Correct.

ARBITRATOR COHEN: Thank you. That's all I wanted to know.

ARBITRATOR PETRIE: But to be clear, you have no data in terms of what proportion of the base period GDC was being paid out and what data in terms of what the subsequent period were paid out?

THE WITNESS: That's true. The only data I have is market studies which

suggest you need about three representatives on staff to support a $127 million book of business. Those statistics are the Financial Planners Association's 2005, what you call the top reps' numbers.

ARBITRATOR PETRIE: The data you gave us on Friday or Wednesday?

THE WITNESS: That's right.

MR. GOOD: Mr. Petrie, I think that's an interesting question. And with all due respect of the panel, let me just point out to the panel that that is --

MR. CAMPBELL: Objection, Mr. Chairman.

MR. GOOD: Wait a second.

MR. CAMPBELL: Running commentary from a lawyer, pointing things out to the panel. Inappropriate while we're in the middle of testimony.

MR. GOOD: That's information we requested by way of discovery and information that this panel suggested that we did not need nor granted us the

opportunity. And that was, in fact, asked for after Mr. Marzano's testimony.

THE CHAIRMAN: Is that something we can do outside the presence of the witness later on?

MR. GOOD: Thank you.

THE CHAIRMAN: Thank you.

BY MR. GOOD:

Q. Continuing in Claimant's Exhibit 11, is there anything else at this point you'd like to point out to the panel?

A. Well, the bottom box we should discuss really briefly. The use of a regression analysis assumes effectively a continuation in the variables, the relationship between the assets under management, and the variable being considered.

It does not include, for example, the effects of lost assets, changing broker-dealers, and the implications that might have on a model. In other words, the analysis that's presented in the regression assumes that 100 percent of the AEFA assets as of February 28th would have reasonably come over to

MultiFinancial. If that's not the case, the regression would not properly or adequately deal with that issue either.

Q. We'll come back to those specific examples in a few moments.

A. Sure.

Q. Did you utilize Mr. Marzano's historical asset presentation in order to perform an analysis?

A. I did. What I did was a twofold test. First, I recreated effectively Mr. Marzano's inputs to ensure that, as I mentioned previously, the math was correct and that the regression was correct.

And, as I said, there's no mathematical or computational issues with the sets of data as presented. What I then did was ran a multiple regression analysis that included the effects of the stock market returns during the 14-month period.

Q. Did you do that as an exhibit?

A. I did. There's actually two separate sets of exhibits. It's Exhibit 3, which is the output exhibit.

Q. Okay.

A. And the stapled exhibit that you have there that shows the calculations in the regression, I have one in my briefcase.

Q. Would you grab the one in your bag.

ARBITRATOR PETRIE: Remind you, Mr. Good, that neither Claimant's 11 or any of these have been offered, so the panel isn't looking at them.

MR. GOOD: I understand. I didn't think it was appropriate to offer it quite yet. I thought I would do it at the completion of the testimony.

ARBITRATOR PETRIE: If you talk about box 1, box 2, box 3, the panel is not looking at the exhibit.

MR. GOOD: Okay. Thank you.

Q. Is this the multiple regression forecast that you have presented?

A. Yes.

Q. That you developed?

A. Yes.

MR. GOOD: At the wise counsel of Mr. Petrie, let me go ahead and move

Claimant's Exhibit No. 11 in evidence now at this point.

THE CHAIRMAN: Mr. Campbell, do you want to be heard?

MR. CAMPBELL: I don't really have an objection other than the fact that I didn't get it previously. And I suspect that won't be good enough to keep it out, Mr. Chairman. So let's take it for what its worth.

THE CHAIRMAN: Claimant's No. 11 now in evidence.

(Claimant's Exhibit 11 previously marked for identification, received in evidence as of this date.)

MR. GOOD: Thank you.

For purposes of identification, let me hand to Mr. Campbell what we will call Claimant's Exhibit No. 12.

Q. Mr. Dahl, would you explain what that is, please?

A. Yes.

ARBITRATOR COHEN: Excuse me again, Mr. Good. Mr. Petrie's point I think

should be elaborated on a bit. Perhaps it's not the legal procedure that you're used to, but I think that if your exhibits were presented to the other counsel and the other counsel has taken the position that, yes, he's going to accept, or no, he's not going to accept. Mr. Campbell, with your permission, we would like to see those exhibits and work along with you. I understood that the witness is presenting to the panel, not to Mr. Good.

MR. GOOD: I understand.

ARBITRATOR COHEN: And we're sort of sitting here and just waiting.

MR. GOOD: Then let me do the following, if I might. Here. I have an extra exhibit here that I need to make copies of. Let me go ahead and please do that. Because I thought I had enough copies for everybody. And then I'll present them all to the panel, as well as to Mr. Campbell.

ARBITRATOR COHEN: Mr. Chairman, is

that all right? Mr. Campbell, is that okay?

THE CHAIRMAN: Sure. That's fine.

MR. GOOD: Thank you. Please excuse me.

MR. CAMPBELL: As long as I get a chance to object, Mr. Chairman.

ARBITRATOR PETRIE: Going off the record.

(Short recess.)

THE CHAIRMAN: Back on the record.

MR. GOOD: I'm going to hand to Mr. Campbell what we'll mark as Claimant's 13.

ARBITRATOR PETRIE: Are we up to 12?

THE CHAIRMAN: Mr. Good, did you say 13?

MR. GOOD: It will be 13. I marked another one as No. 12 that I haven't given to the panel yet.

ARBITRATOR PETRIE: But you've given it to him?

MR. GOOD: I just gave him a copy.

ARBITRATOR PETRIE: 12 and 13.

THE CHAIRMAN: Will there be more exhibits following 13?

MR. GOOD: There may be one more. And I can actually mark that as well right now.

THE CHAIRMAN: While we're doing this housekeeping, Mr. Good --

MR. GOOD: Yes.

THE CHAIRMAN: -- do you have witnesses after Mr. Dahl?

MR. GOOD: We do. We have four advisors starting at 1:30 today. It will be 1:30, 1:45, 2:00, and 2:15. And then likely we will be completed.

THE CHAIRMAN: And that's on telephone, I assume?

MR. GOOD: On telephone, unfortunately. Yes.

THE CHAIRMAN: You anticipate finishing with Mr. Dahl in time for Mr. Campbell to do his cross-examination?

MR. GOOD: I absolutely do.

THE CHAIRMAN: Perfect. Fine. Give

us time this afternoon to do our deliberations and your close?

MR. GOOD: Yes, sir.

THE CHAIRMAN: Good. We're on schedule. Excellent. Thank you.

(Series of output data marked Claimant's Exhibit 12 for identification as of this date.)

(Document consisting of a least squares regression analysis by Mr. Dahl marked Claimant's Exhibit 13 for identification as of this date.)

(Document consisting of an analysis of monthly changes in assets marked Claimant's Exhibit 14 for identification as of this date.) BY MR. GOOD:

Q. Mr. Dahl, tell us what Claimant's Exhibit 13 is, please?

A. Just so I'm clear, 13 is the stapled package?

Q. Yes.

A. Exhibit 13, my understanding is that Mr. Marzano used the Excel formula to calculate his least squares regression. So we

stuck with the Excel product. And actually used Excel's multiple regression product to include a second variable in the model for calculating assets under management growth.

Q. So you developed, you did this based on in response to Mr. Marzano's calculations?

A. Yes. That, and Excel is an accepted tool for calculating such variables.

Q. Tell me what Claimant's Exhibit 12 is.

A. Claimant's Exhibit 12 is a series of outputs between February 29, 2004 and December 2, 2005, using this improved regression analysis where we now considered both stock market returns as well as date in calculating assets under management or forecasting assets under management.

Q. Historically, looking back, based upon actual returns?

A. That's exactly right.

We used, if you look back to Claimant's 13, the second page there shows you the inputs that were calculated or used. Column

1, assets under management, and column 2, date, are identical to the inputs in Mr. Marzano's calculation.

Q. And that's based upon information that Mr. Marzano provided to us?

A. Yes, it was. I did not independently verify those numbers.

Q. Explain what Exhibit No. 14 is.

A. I'm sorry?

Q. I didn't give it to you.

A. That's 12, I believe. Oh, I'm sorry. Now I understand. Mr. Campbell has 14.

MR. GOOD: I apologize. Here you go, Tom. I thought I had given it to him.

THE WITNESS: There's two boxes on exhibit --

Q. Just explain what it is.

A. On Exhibit 14 the top box is an analysis of the monthly changes in Mr. Marzano's assets and the monthly change in stock returns.

Q. And it's based upon information and numbers developed by Mr. Marzano that he presented?

A. That's exactly right.

MR. GOOD: I'd like to hand to the panel what would be Claimant's Exhibits 12, 13, and 14 and move them, introduce them into evidence.

THE CHAIRMAN: Mr. Campbell?

MR. CAMPBELL: I've never seen them before, Mr. Chairman. I won't know what they are and what they mean until the witness testifies. Other than an objection they were not previously provided to me, I don't have an objection it to.

THE CHAIRMAN: Claimant's 12, 13 and 14 are all in evidence.

(Claimant's Exhibits 12 through 14 inclusive, previously marked for identification, are received in evidence as of this date.)

MR. GOOD: The multiple regression forecasting would be No. 12. The two-page is No. 13. And historical asset analysis will be 14.

THE CHAIRMAN: Thank you.

ARBITRATOR PETRIE: Not to be confused with Exhibit 11 which has the same caption on it.

MR. GOOD: Right.

THE CHAIRMAN: Okay, Mr. Good.

MR. GOOD: Yes. Thank you.

Q. Does it pay to start with Exhibit No. 13, Mr. Dahl?

A. Yes.

Q. Would you explain to the panel Exhibit No. 13, please.

A. Exhibit No. 13 is a two-page document that includes an improvement on Mr. Marzano's original regression analysis to include the impact of the S&P 500 and its relationship to his assets under management growth.

Q. Now, you used the word "improvement."

Tell the panel what you mean by the word "improvement."

A. By adding another variable that clearly has direct and positive relationship with asset

growth, we increased the ability of the model to explain changes in historical asset under management numbers.

In this case, Mr. Marzano's, the explainability went from his original model which appeared to explain 93 percent of all changes in assets variability to 99.25 percent of the change in assets under management now being explained by this current model.

Q. Is there a mathematical symbol or something that you call that?

A. That's termed an r-squared. It's a measure of the variability between expected and actual outcomes when a mathematical equation is run against historical data.

Q. Now, I believe that Mr. Marzano testified previously that the r-squared factor that he utilized was 93. Now that sounds pretty good.

A. Right.

Q. What was the r-squared factor based upon the information you developed?

A. 99.25.

Q. Tell me what the difference is

between that and what the significance of that is to the model.

A. It means that the model now better explains variability in assets under management growth at the time.

Q. When you say "better explains," what does that mean?

A. It means that when we look back at the historical 14 months that are being utilized in this case, and look at actual assets under management growth by using two variables instead of one, we now have a better ability to explain changes in the assets under management growth on a month-by-month basis. So that going forward we now know that by adding the second variable we have a model that better explains projections or forecasted asset growth.

Q. What is it that made it, to use your phrase, better? What made this model better?

A. It explains a higher percentage of asset variability or historical variability in the actual monthly asset growth.

Q. Through the use of what

information?

A. Stock market returns, as well as time.

Q. Does that make the model that you developed statistically more significant?

A. It is a statistically more significant model, yes.

Q. What does the phrase statistically significant mean for the panel?

A. The test of statistical significance is an important part of applying regression analysis. It implies that the model which is ultimately simply a hypothesis about how the future will unfold can be better explained or likely explained by using or considering the variables that are in a specific model. And when a model is statistically not significant, then its ability to forecast historical factors is lower, and in this case, much lower than what a model like this would suggest.

Q. Would you go through your worksheet here, Exhibit No. 13.

A. Sure.

ARBITRATOR COHEN: Mr. Good, I'm having some difficulty hearing the witness.

Can I ask for a favor, please.

MR. GOOD: Whatever you need, please. Would you like me to switch seats? Why don't we do that. Not a problem. That makes sense. Let's do that.

Q. Are you ready?

A. You bet.

Q. Go ahead. Please explain your worksheet, Exhibit 13.

A. Let's start with the second page, the back stapled page.

This is the series of inputs which we've discussed previously. Column Nos. 1 and 2 are identical, if I'm not mistaken, to Mr. Marzano's input data in his original regression analysis.

Q. Keep your voice up.

A. You bet.

Column No. 3 is the addition of a third set of variables, that being the Standard

& Poor's 500 for each of the specified dates in the middle column.

So sort of to continue the discussion in terms of a regression analysis, we are considering the implications of time and market growth on the change in the first column, that being assets under management.

Q. Okay.

A. The first page provides a number of outputs that are calculated by using a regression analysis such as this. The multiple regression equation is the equation for the line that explains the data set.

I believe Mr. Marzano testified to the line being a best fit line or a line that minimizes the difference between actual data and forecasted data. As you can see, that line is there.

The second column over provides some data.

Q. What is that second column called?

A. Independent analysis. I'm sorry. That would be second box over.

Q. Right.

A. It provides some data relative to each of the inputs and how they are relevant to the output. In this case, the output is the assets under management.

Q. Explain what it is you're looking to do there.

A. The model here tells us that both of these factors, both date and time, excuse me, time and the Standard & Poor's index alone are very important explaining factors in the modeling of assets under management growth.

Q. Okay.

A. There are a couple of additional tests here. The test, particularly statistically significance, that are included on this page. But really, the focus of this analysis should be on the first two points.

Q. Okay.

A. Two variables highly correspond with the assets under management growth. And they have a strong degree of explaining power in terms of forecasting. And a final note: They should both be considered together. You should not run a model of just one of these two

variables.

Q. Bring me down to the bottom of the page and explain what that is, please.

A. The line you see there is the line that is forecasted by use of the mathematical equation shown slightly above it. 29.6 times date plus 63.0 four times Standard & Poor's.

Q. I don't have any idea what that means. So please explain to the panel in somewhat understandable terms, in layman terms --

A. I'll do by best.

Q. -- what it is you're showing here.

A. What the mathematical equation shows is the relationship, the mathematical relationship between Standard & Poor's and any specific time and assets under management and date at any specific time and assets under management.

It tells you effectively at a given time at a given rate for the Standard & Poor's 500, your closing price for the Standard & Poor's 500, what the outcome would be for expected assets under management at that point

in time.

It's done by looking historically over the 14 months that are included in the data set. And by effectively developing a mathematical relationship between change in one variable, this being Standard & Poor's or time, and the outcome assets under management.

Q. Let me stop you here.

Previously you testified that using those 14 months was inappropriate because it was a shortened time frame.

A. Right.

Q. Why is it appropriate for you to utilize that 14 months?

A. It would be far better to use a longer period of time.

Q. Okay.

A. The assets under management data was not available over the longer period of time. And we were simply, to be honest with you, looking at Mr. Marzano's work and the reasonableness of it.

By holding constant or by adding Standard & Poor's as a variable, we're able to

hold constant the effect of the stock market returns on his asset growth, and thereby, effectively improve the model over that shortened period of time because we've taken that wild fluctuation in the market out of the equation.

Q. So the adding of the S&P 500 improves the statistical significance of the modeling of the equation?

A. Yes, it did.

Q. Anything else on this first page?

A. No.

Q. Let me ask you to take a look at Claimant's No. 12.

A. Yes.

Q. And explain to the panel what that exhibit is, please.

A. This is the regression analysis looking forward, using the mathematical equation that was forecasted, using Excel's multiple regression analysis.

We then looked at the Standard & Poor's 500 over a series of time, dates over a series of time through to December 2nd. And

forecasted the expected, based on that mathematical equation, the expected assets under management for each of these periods of time.

Column 1 shows you a series of dates that would be in the future or in the future relative to the stopping point of the regression analysis. That is from the point of leaping up, which is February 29, 2004, how does this linear line forecast assets, given the occurrences in the stock market.

Q. Why did you select these dates?

A. They're actually quarterly dates through 9/30. And I included 10/31 and 12/2/2005 simply to effectively update the data.

Q. Please explain --

A. Sure.

Q. -- what these numbers show.

A. The dates, as we move toward the corresponding S&P 500 is provided for each of those dates. Based on the relationship between assets under management and time, there's a forecasting of actual assets that would be expected going forward from these dates.

The output as you can see is

growing from 69.2 million to 95.8 million over the 18, 20 months. The column aside that is an inclusion of some statistical data that gives you an idea as to what our expected parameters around those based on the model inputs are.

It basically says starting in February 29th that anything between 68.3 and about 70.2 million, if it's within the realm of the population data, this is a statistical tool that allows us to get a handle on reasonableness of an output relative to actual occurrences.

Q. Now, this forecasting includes an assumption; is that correct?

A. Yes.

Q. What is that assumption?

A. The primary assumption here is that 100 percent of the asset base of Mr. Marzano would have carried forward with him to MultiFinancial. There's no implication, there's no ability for this model as structured to account for the single or one-time effects of moving assets to the new broker-dealer.

Q. So this would assume either Mr. Marzano staying at AEFA and what the effect of

the market would be on his book of business at that point, or 100 percent of the assets traveling with him to MultiFinancial?

A. Yes.

Q. What else does this show us?

A. I think that's it. I think we've covered everything. It kind of shows, the way to probably best look at this is the last two columns; the plus or minus one standard deviation.

The model says better than a specific output is that the model explains assets under management for the current period of somewhere between 94.8 and $96.8 million. That would be the reasonable realms of the model's explaining powers.

Q. Now, these numbers are not the end result of how you would evaluate the value of his book of business; is it?

A. No.

Q. What else do you need to consider?

A. This is based on Mr. Marzano's testimony. But it's my understanding that approximately 210 clients had been added in the

two years immediately prior to leaving American Express.

Q. What does that mean?

A. It means our calculation shows he had about 253 clients on February 29, 2004. It means these clients are less than, on average, less than two years with Mr. Marzano. There is a very real effect of time and your retention of assets. There is a natural tendency for clients to change advisors over time. I believe, in fact, Mr. Marzano's own analysis suggests a five-year lifespan for his clients.

What this means is that since Mr. Marzano was at most four years into a relationship with his clients, and based on the number of clients he added in the two years prior to leaving and his actual client numbers, probably significantly less than four years into a relationship he had not begun to experience natural attrition of his client base. That is a factor that should have been considered in any meaningful analysis as well.

Q. In studies in the practice that you do, is there a percentage of business that when

an advisor leaves one broker-dealer and goes to another, is there an identifiable percentage for whatever reason --

A. Right.

Q. -- that does not follow that broker?

MR. CAMPBELL: Objection, Mr. Chairman. I don't think this witness is qualified to give that particular opinion. He has not testified about his background, his experience, or anything to do with competitive hiring, competitive environment in moving from one broker-dealer to another. Valuing practices, yes. Litigation support, yes. But I see no evidence that he's an expert for that subject.

MR. GOOD: If the panel will recall, I began to go down that road with him last week, to go through those issues and everybody said we think he's an expert. And I never went any further with that issue. But I can develop that if that's what the panel wants. But

we did, in fact, head down that road.

THE CHAIRMAN: I understand. And we'll let you continue your questioning.

MR. CAMPBELL: With all due respect, Mr. Chairman, why don't we let him go down the road and let's see if he is an expert on that subject as opposed to what he covered last time.

ARBITRATOR PETRIE: I think we just ruled on that point. And given that we've qualified this witness as an expert in valuation, and valuation is obviously something that takes into account attrition among other things, we're satisfied that he can talk to this.

THE CHAIRMAN: If in impeaching him, Mr. Campbell, you need to bring that out, feel free to do so. But we're allowing Mr. Good to continue.

Q. Do you recall the question?

A. I do.

Q. Go ahead.

A. There is one specific study that's performed regularly, I want to say annually, but

it might be by annually, by a company called FP Transitions. And FP Transitions is, they're really a business broker, for lack of a better way of describing them. But they did publish a report. The last one that I saw was in 2002. And the report suggests about a 5 percent attrition rate when a dealer, excuse me, when an advisor leaves broker-dealers.

Q. And that 5 percent are assets that are free to leave, and easy to transfer by ACAT or whatever way, without taking into account any other type of limitations or negative financial impacts of a financial product on a client?

A. It would be my belief that that's correct. It is not quite as clear as that in the data. I want to just qualify that.

Q. All right.

So at a minimum, 5 percent ought to have been evaluated or at least accounted for in this instance, correct?

A. Yes. There had to be some transitory impact. And the 5 percent is the best market data that's available that I'm aware of.

Q. Are we aware of certain transitory limitations from Mr. Marzano's own testimony that you have been able to determine?

A. Right. There are some specific issues related to a significant set of the assets.

Claimant's Exhibit 11, I believe, has a summary that might be helpful to refer back to.

Q. Then let's go to Claimant's No. 11.

A. I apologize for putting it at the very top and very bottom of the list. But the assets left at AEFA, client transferred assets not subject to redemption to MultiFinancial, I note there's a typo. The "not" shouldn't be there. I apologize for that.

These are client transferred assets that are subject to redemption at AEFA. This number is generated in the following way: It was my understanding that Mr. Marzano testified there are about $4 million in assets that he concedes are locked up, if you will, at American Express. And but for that lockup, would have transferred to him at MultiFinancial.

Q. Let me stop you there.

You said it's your understanding that Mr. Marzano testified. From what do you base your understanding?

A. Those are discussions with counsel.

Q. Now, did you read Mr. Marzano's testimony as well?

A. I didn't read that day's testimony.

Q. Okay.

A. That's since I finished.

Q. Go on.

A. The 4 million, it's also my understanding Mr. Marzano testified that that number's inflated because it includes -- it's a number as of September 2005. So what I did was, based on the market returns up above, I calculated what the gain on the asset base was and reduced those assets accordingly to 3.73 million as shown in the top line there.

ARBITRATOR PETRIE: Excuse me. I'm a little confused as to what's the difference between your first line there: Client transfer assets subject to redemption, MultiFinancial, and the last

line, assets at AEFA subject to redemption charges.

THE WITNESS: Good question.

ARBITRATOR PETRIE: Is the first line assets that didn't move, presumably because they were subject to redemption charges?

THE WITNESS: That's right.

Of the 18 million in assets that didn't move, that would be the component, it was originally, I believe, looked at and believed to be, and we've seen the data suggest about 6 million in assets. Of which Mr. Marzano, I believe, has testified is slightly incorrect. Or a couple of client accounts that shouldn't be included in that base. So we adjusted it to his oral testimony of $4 million. And adjusted it downwards from there.

The second part of that, the 3.9 million is, we reviewed the $11-plus million that remained in the accounts and looked at what level of those assets -- these are clients who did not move money

over to MultiFinancial, were also locked up by Class B mutual funds/annuities.

So the 3.9 million is, if you think of it as the 18 million, is made up of a subset of clients. The 3.7 million is that subset of clients who did move some of their money over to plaintiff, while the 3.9 million is that subset of clients who moved no money to MultiFinancial.

ARBITRATOR PETRIE: So that's the differential. It's a different client universe between the two numbers?

THE WITNESS: Yes. That's correct.

ARBITRATOR COHEN: So effectively what you're saying is that $7.6 million worth of assets stayed there because they were subject to redemption?

THE WITNESS: They were $7.6 million of assets that were locked up. It's not my testimony that they stayed there with any certainty.

There's really two classifications of assets here: The 3.9 million that we

know for certain stayed there based on Mr. Marzano's testimony, and an additional 3.9 million which would have been subject to significant redemption charges.

ARBITRATOR PETRIE: In other words, what caused some confusion, at least for me, was the word less in front of the last line.

THE WITNESS: Right.

ARBITRATOR PETRIE: These are all added?

THE WITNESS: Right, right.

Q. Now, you also have additional names of certain clients.

A. Right.

Q. Tell me what the significance is of that being there.

A. The five clients that are listed here, it is my understanding that none of these five clients had any intention of moving assets to MultiFinancial by Mr. Marzano's departure.

The asset numbers that are included here are not the asset totals that you'll find

on their statements. They are adjusted to remove all of their locked up securities, if you will. All of the securities that would be included in the redemption charges. I did that so we would avoid double-counting of the assets.

Q. And the total that you come to?

A. Slightly over $11 million.

Q. Now, what's the significance of that number relative to the analysis and a total that was presented by Mr. Marzano?

A. The forecasting tool, the regression forecasting tool effectively assumes that when you jump off from February 29th to March 1st or from March 31st to April 1, 2004, you continue on the same trendline as you were before.

The same asset base, the reduction in assets will effectively reduce or drop the line down in parallel fashion, pretty much in similar fashion to Mr. Marzano's testimony prior about how he raised the line. This would suggest an actual reduction in the line should be accounted for and considered.

Q. 14.

A. Sure. I think we talked about the top of 14.

Q. Let's go to Claimant's Exhibit No. 14.

Tell us what Exhibit No. 14 is and how that fits together with your analysis here.

A. Sure.

The top box, monthly assets per Marzano's work papers is simply the assets under management, indeed that we've been discussing this morning.

The third column over shows the difference on a monthly basis between the numbers provided by Mr. Marzano, 5.9 million, 2.9, et cetera.

The middle column shows the market growth based on our projected 26.1 percent growth rate in assets.

And the final column is really simply the monthly change minus the market growth to give you an idea as to what the asset growth on a client basis was for the period of time examined.

Q. Okay.

A. The second box is our summary of the financial statements -- excuse me -- the broker's statements as provided.

As you can see, we had total assets in March of 2004. We reviewed total asset statements totaling 70.2 million. In fact, actually almost 70.3 million. In September of 2005 those AEFA assets were 18.6 million.

As you move down, column by column, fixed assets and annuities were 32 percent in 2004, 38 percent in 2005. Equities were 60.3 percent in 2004, 50.5 in 2005.

Money market, as I mentioned before, we included that as a component in the fixed income products was 7.7 percent to 11.3 percent.

We also looked at clients greater than 60 years old per the statements and clients that reported on their AEFA filing to be relying on assets as a source of income.

And I need to clarify something that I stated in our first session. It appears to me that we had an original statement that

included a number of duplicate accounts. And the effect of that was to skew our first analysis of the data. We since corrected that.

Q. What is the correction?

A. The correction is to reduce the client assets, I believe it was my testimony the client assets, saved assets, if you will, was roughly 30 percent. As you can see, it's actually in March of 2004 about 13 percent.

Q. Okay.

A. It's higher, interestingly, the money that stayed over appears to be higher now. In other words, more people with saved assets stayed with American Express than left and went to MultiFinancial as a percentage of the total asset base.

Q. Now, based upon your testimony today, those last two indicia, the client assets greater than 60 years old and client assets relying on saved assets, what is the statistical significance, what is the significance of that information relative to the modeling of the damage calculation?

A. As I mentioned previously, we're

looking at a very short period of time here in terms of what we're regressing. And during that period of time there is clearly strong growth in Mr. Marzano's client base. So much so that his average client has not been with him a significant amount of time. As a result, the level of redemptions hadn't started to grow towards the industry average.

In other words, his client base hadn't aged and started moving the assets. But they're getting really close. Particularly with about a quarter, slightly under a quarter of his total asset base clients over the age of 60, it's reasonable to assume that some of those will begin to redeem their securities. And that redemption may be at a significantly higher rate than his current rate. And that's another factor that should be considered in a forward-looking model.

Q. What about the second item, client assets relying on saved assets, what is the significance of that?

A. It's a similar test. It's a similar consideration. Because the information,

assuming that it's correct on the American Express Financial Advisors planning statements, required them to indicate where their principal source of income is.

It gives us further evidence as to whether or not these are clients that will be reducing their assets or living off of saved assets, or continuing to increase their asset base by adding to their mix or adding to their portfolio.

Q. So at least, in part, part of your opinion is that the analysis done by Mr. Marzano is an incomplete analysis?

A. Yes. I would agree with that statement.

Q. Now, do you have an opinion as to what the regression analysis ought to show as of -- what is it that the regression analysis shows as of 10/31 of '05?

A. For that?

Q. The one that you performed.

A. And I'll refer back to Claimant's Exhibit 12. The second to last line which, as you can see, shows an input for the Standard &

Poor's of 12/07 shows estimated assets at 10/31 of about 91.2 million.

The regression as run with those two inputs suggests assets under management of somewhere between 90.2 and 92.2 million would be reasonable based on those two input factors in the regression model.

Q. What was the regression analysis number that Mr. Marzano utilized?

A. 127 million, including the additional 9 million, the linear increase.

Q. Now, from this number, from this 91.2 to 92.2, that is, again, assuming that 100 percent of the assets moved over or stayed with Mr. Marzano, correct?

A. Yes, it is. Yes.

Q. From this point how do you now complete the analysis after that?

A. Based on the mathematical equation here and those additional assets, you would subtract those from this output dollar-for-dollar.

Q. What does that number then become?

A. It would actually be -- let me just

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refer back, I apologize, to Exhibit 11.

11 million less than 90 or 92 million would give you a number of between 80 or 81 million as an indicated assets under management base.

Q. Do you recall what Mr. Marzano has today?

A. I have not reviewed the statement. But it's my understanding it's about 94 million as of September 30th, if I'm not mistaken.

Q. Greater than what the multiple regression forecasting would demonstrate?

A. That's correct.

Q. And therefore, he would have no damages?

A. That's absolutely right.

Q. Now, other factors relative to how the numbers could be affected and moved to a client asset, would errors in contacting clients or delays in contacting clients by Mr. Marzano have an effect?

A. I think it's undeniably in evidence that Mr. Marzano believes it did have that implication. It's reasonable to assume that the

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failure to contact clients upon leaving would have a negative impact on your ability to maintain clients.

MR. GOOD: If the panel would give me a moment...

THE CHAIRMAN: Sure.

MR. GOOD: May we step outside for a moment because we may be close to completed.

THE CHAIRMAN: You want to take a morning break?

MR. GOOD: That will be fine.

THE CHAIRMAN: Back in 10, 15 minutes.

MR. GOOD: Yes.

(Short recess.)

THE CHAIRMAN: Mr. Good, back on the record.

MR. GOOD: Thank you. Just a few more questions. BY MR. GOOD:

Q. Owen, I want to show you Claimant's Exhibit No. 7 that has previously been introduced into evidence.

MR. GOOD: And, for the panel, that

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is entitled, "Clients That Had Invested With aEFA And Opened Accounts At MultiFinancial." It's Claimant's Exhibit No. 7.

THE CHAIRMAN: Yes. Give Mr. Campbell a moment.

MR. GOOD: Yes, of course.

MR. CAMPBELL: All right.

Q. Owen, have you had an opportunity to review Claimant's Exhibit No. 7?

A. Yes, I have.

Q. Now, what does that information, what does that information develop for you?

A. This is a list of clients by ID number and dollar amounts in accounts as of September 2005 for clients who left, who opened accounts at MultiFinancial with Mr. Marzano, but retained some asset balance at American Express Financial Advisors.

Q. Does that information on Claimant's Exhibit No. 7 correlate to a number?

A. Yes.

Q. That you've utilized in your

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calculations?

A. Yes. It's the top line. Going back to Claimant's Exhibit 11...

Q. 11?

A. The top line in the bottom box, 3,734,000. It is the 6 million minus 2 million as testified to by Mr. Marzano of assets that he disputes the validity of on this list.

Q. I understand.

A. Adjusted for a 4 percent market growth rate over a period of time, September-October 2005 back to March 2004.

Q. Now, the bottom number on Claimant's Exhibit No. 11, the 3.9 million --

A. Yes.

Q. -- now that number are assets that stayed at American Express with no MultiFinancial accounts, correct?

A. That's exactly right.

Q. How did you develop that information?

A. We have a spreadsheet with the clients listed and the assets by type. And we cross-referenced the clients, the total clients

that stayed with American Express, or maintained accounts I should say, as of September 2005 at American Express against this client list here. The clients who are not on this list.

MR. ZARETSKY: "This" meaning?

Q. Meaning?

A. Exhibit 7 list.

Constitutes our subset we were chatting about earlier with the 11 and change million dollars' worth of clients who had assets at American Express and did not open accounts at MultiFinancial.

Q. But you went into the actual account statements?

A. We did.

Q. And reviewed those?

A. That's right.

Q. So you went into the March of '04 and '05 account statements that were presented to you?

A. In the March of '04 statements that were provided to us for all the clients who maintained accounts at American Express and are not on this list.

Q. And that's how that number of 3.9 million was developed, off of the actual account statements?

A. That's exactly right.

Q. That number 3.9 represents not the total number of assets, but only those assets that are locked up as annuities, B shares, or insurance, or money that would have a negative financial impact on a client to transfer?

A. That's right. It's significantly annuities and B shares. Yes.

Q. Now, one other issue that I want to discuss with you that Mr. Marzano testified to. And that is a discount rate.

A. Right.

Q. Now, notwithstanding the fact that the regression analysis that was done as a complete analysis demonstrates that there are no damages to Mr. Marzano, the discount rate of GDC that Mr. Marzano utilized was 5 percent.

Is that a correct figure?

A. This is an area that we spend a preponderance of our time on in a valuation field. A 5 percent discount rate, a rate that's

reflected by U.S. Government bonds has no place in the forecasting of assets under management in broker-dealers' concessions and the present valuing of those cash flows back to today.

Q. Now, while I have little doubt that the panel understands what a discount rate is --

A. Yes.

Q. -- explain, by using a 5 percent discount rate, what Mr. Marzano is telling the panel and why that's an incorrect percentage and assumption.

A. Implicitly, Mr. Marzano is saying that by investing $2.0 million in an asset that's secured by his prospective client base, that $33 million in clients that he's purporting to have lost as a result of this action, a reasonable investor would accept a five-year return of 5 percent on an asset that's secured by such assets.

Another way of looking at it is, if Mr. Marzano had a choice between investing $2 million in a $33 million book of business or $2 million in a government/stock market, he should accept the exact

same rate of return between those two investment choices.

Q. In your practice and in your experience, is that a correct number?

A. No.

Q. Is that a correct valuation that a representative or advisor ought to be paying --

A. No.

Q. -- for this book of business?

A. No.

Q. Why not?

A. The risks associated with a forecasted cash flow that is based on assets under management and eventually gross dealer concession and then should have been net income, is a forecast that is inherent with significant forecasting risk, not surprisingly. And there's no way effectively around that.

At the end of the day, a forecast is only as good as your forecast of the future. We don't know what the stock market will do on an ex-ante basis as we sit here at February 2005. We don't know what asset growth rates are going to be.

There are significant competitive issues in the market that we're familiar with such as an increase in the number of reps and advisors on an annual basis. These factors are all factors that eventually affect the discount rate or the rate of return required to discount a future set of cash flows back to present value.

Q. Does that include the calculations that he did before about the stock market growth, that period of time that there was an abnormally high growth versus a period of time where the market was moving sideways or slower?

A. Yes.

Q. And that's one of the reasons why a 5 percent discount rate is inappropriate?

A. That's right.

Q. What about the amount of money that didn't move?

A. Again, these are all factors, particularly when you're talking about transition of a book of business either from one broker-dealer to another or in the case of the sale of a practice from one advisor to another.

These are all factors that have significant implications on the rates of return that are necessary to induce an investor to purchase a book of business.

Q. Other factors, aging of the book of business?

A. Yes.

Q. Whether individuals are using money to purchase second homes or other types of consumer oriented investments or luxuries?

A. Yes. Very much so.

Q. What about change in employment status?

A. The change, you're talking about the client base?

Q. Yes.

A. Those can all be implications that affect the future of growth in assets. Also factors such as, for example, relative profitability of one planner's book of business versus another. Relative duration or relative age of the base or book of business. Younger or new books of business have higher risks going

forward as far as forecasting goes.

Q. And therefore, the assets under management utilized by Mr. Marzano were incorrect, correct?

A. Correct.

Q. Yes?

A. Yes.

Q. And the discount factor utilized by Mr. Marzano was incorrect?

A. Yes.

Q. And that's because he didn't take these factors into account in developing his discount factor?

A. That's exactly right.

Q. In your experience and in your business, what is an appropriate discount factor for a book of business like Mr. Marzano's and why?

A. The typical rates of return for very similar books of business that we value on a regular basis is about 18 to 22 percent. That's for the sale of a practice.

Now, there's a couple of things that are important to note here. There's not a

direct correlation between a sale of a practice and Mr. Marzano's transferrance from broker-dealer. Therefore, we would have spent a lot more time analyzing the rate of return issue if it was relevant.

But as I mentioned to begin with, we don't see that there's an assets under management deficiency here. And, so really, the discount rate issue, if we were to run the model, would be moot. There are no asset losses. If there were, however, we would need to develop a rate of return that's consistent with the risks associated with Mr. Marzano's forecast.

To give you an example of the implications, if you run the same analysis as Mr. Marzano's with an 18 percent discount rate, the damages calculation is 25 percent lower. If you run it somewhere in between 5 and 18 percent, just for sake of argument, 12 percent, the rate of return is 15 percent lower.

MR. GOOD: Mr. Chairman, I have nothing further of the witness at this moment.

THE CHAIRMAN: Thank you.
Mr. Campbell, do you need a few moments?
MR. CAMPBELL: I'm going to try and proceed, Mr. Chairman. Because of the newness of these numbers, and we're still, these exhibits we're still trying to understand them, I'm going to have a lot of interaction with Frank as I do this. But to try and move it along, rather than go out and get a list and come back in, we'll just try to work it as we go. So Frank may be supplying some of the questions directly.

CROSS-EXAMINATION
BY CAMPBELL:

Q. Just to pick up on that last point, Mr. Dahl, can you distinguish for me the differences between valuing a practice and measuring damages?
Are those two different functions?
A. It would depend. Are you asking generally or specifically?

Q. Yes, generally.
A. In general, we depend on the case. There are many times where a valuation or, excuse me, valuation is specific or pertinent to the calculation of damages.
Q. Well, for example, if you were valuing Frank's practice for purposes of buying it, employed by another advisor who wants to know what's an appropriate price to pay for Frank's practice, you would come up with one number, right?
A. Yes.
Q. And perhaps it would use the typical factor, I think you said 16 to 18 percent for what was that, 16 to 18 percent?
A. I believe it was 18 to 20.
Q. Eighteen to 20?
A. Sixteen would be a little bit low for a practice of this nature.
Q. What is that, 18 to 20?
A. It reflects the rate of return that would be required by an investor to induce him to purchase Mr. Marzano's practice.
Q. Of course if someone were

purchasing Frank's practice, Frank wouldn't be there anymore. It wouldn't be Frank working the practice, growing the practice, developing the practice, right? It would be the new buyer?
A. Well, actually, that's not necessarily the case. And it's not typically the way these books of business are sold. They're sold on the net. And they're sold with very specific provisions about what assets stay.
Q. The assets that stay, in fact, the selling advisor usually hangs around to help keep the assets in place for some period of time, right?
A. Yes.
Q. But of course the rate of growth in the assets, new assets as opposed to market growth, the rate of growth in the assets, that will be determined by the new owner and his or her abilities and performance, right?
A. Yes.
Q. Will no longer be determined by Frank's, because Frank is no longer growing that business?
A. That's true.

Q. That's right.
But you know in this case we're dealing with Frank throughout; aren't we?
A. Yes.
Q. And you testified, I think, on one of your exhibits, I just want to make sure I understand it, because you testified a lot about the asset growth due to market performance.
A. Right.
Q. But the bottom line is, as I look at Claimant's Exhibit 14, you got that in front of you?
The bottom line is using the numbers that you have on this exhibit in the top box --
A. Right.
Q. -- which I'll come to in a minute.
But you have calculated the average adjusted change, net of market performance, at just a little over $2 million?
A. Yes, that's correct.
Q. And that's Frank's performance; isn't it?
Frank brought in an average of a

little over $2 million in new assets, either new clients or new assets from old clients every month?

A. Certainly no evidence to suggest otherwise, no.

Q. And, of course, if you're valuing the business you couldn't assume that the new owner would do the same?

A. I think I follow. I apologize. What do you mean?

Q. If you're valuing the business for purposes of it being sold to a new advisor, you couldn't assume in doing your valuation that the new advisor would continue that 2 million per month?

A. Oh, I see. I apologize.

No. The forecasting model that you used, the cash flow or earnings approach would use some presumed growth rate that would have reflected market growth, as well as a different new asset growth reflective of the purchasing individual's ability to grow a business.

Q. And that might be zero?

A. Yes. It's very case-specific. Yes.

Q. Do you have any reason to utilize as an assumption in doing a trend analysis, let's say Frank in March of 2004 had approximately $79 million in assets, if you were going to trend that forward using the numbers that you had available, is there any reason why you wouldn't assume $2 million average per month asset growth for the number of months between March '04 and today, December '05?

A. There's a couple of reasons I've testified to that also need to be considered.

As I mentioned previously, this is a very new book of business with a very short lifespan of client relationship with Frank; at least relative to the data that's been provided. That is 200, and this number is rough, I believe it was 210 clients in the last two years were added to Frank's book. There's 253 clients on the record as of February 2004. In other words, only 43 clients predate two years prior. The attrition rate in clients is a function of time as well. And it's a time frame that has not been developed yet in Frank's or Mr. Marzano's book of business.

So the factors such as that, such as I mentioned previously, age of client, also need to be considered before I would be comfortable opining $2 million in assets growth in perpetuity.

Q. So if Frank had a relationship, let's say going back, five or six or eight or 10 years with those clients, then you would feel better in projecting forward that he was going to have a lower attrition rate?

A. Well, again, this is speculative as I sit here because these are not factors that I considered specifically. But I think you need to differentiate between the relationship as a financial advisor and a relationship in another sense.

There are, I don't want you to get the idea that I've analyzed this, specifically this case, but these are all factors that need to be considered when valuing a book of business.

Q. In fact, there are studies that look at the degree of trust that clients have in their relationships; aren't there?

A. There are, I suppose there are some

anecdotal studies. I'm personally not, I'm certainly not an expert in that. I wouldn't comment on them.

Q. So you don't know about any such studies?

A. Only sort of in a third party way. I've never reviewed such a study.

Q. To the extent that you do know, which relationship is the one that you've heard about that is the one that is the closest relationship the clients have with a particular kind of professional?

A. One more time. I apologize. I didn't quite get the thrust of the question.

Q. Maybe I should ask it a different way.

A. Okay.

Q. Have you ever heard that the relationship between accountant and client is the closest relationship between a client and a professional?

MR. GOOD: Objection as to whether he's ever heard it. If he's asking is there a study that he's aware of or if

there is a basis for it, other than something he heard.

Q. Is there anecdotal information that you have, that you've collected in your experience in your business either as an expert witness or as business --

A. I think I've heard the statement once or twice. I think that's about as far as I can possibly testify to.

Q. And, of course, you know that Frank was a CPA for many years before he was a planner?

A. I realize that. Yes.

Q. And many of his clients came from his CPA practice?

A. If that's true, I'll take your word for it.

Q. It's not something you looked at?

A. No.

Q. So you don't know what proportion of the clients came from his CPA practice relationship?

A. No. But it would explain the very strong growth rate in his first four years. No

question about it. It would also suggest there's a limit to the amount of those assets would grow going forward. There's a point in time obviously when you've exhausted the prior relationships.

Q. Can't have more than 100 percent, right?

THE CHAIRMAN: One at a time, Mr. Campbell.

Q. Once 100 percent of the CPA clients become planning clients, then that's not going to be an area of much growth anymore?

A. Well, you'll certainly not go over 100 percent. That's for sure.

Q. Now, I think you told us that you spend about a third of your time doing litigation support?

A. Yes. That would be accurate.

Q. In litigation support as opposed to factor used, the rate of return that you looked for in a sale of a practice situation, what is an appropriate discount factor to use for a five-year damage number as opposed to sale of practice number?

MR. GOOD: Let me just object to the form of the question. He's tying, and the question's not clear to me, but it may be to Mr. Dahl. But what he said was his litigation practice and valuation and rate of return, his litigation practice may not be just dealing with rates of return on the sale of practices.

And I just want to clarify the question. If you understand it, I suspect you can answer it.

THE WITNESS: Okay.

THE CHAIRMAN: Can you answer?

A. Okay. The question, if I'm not mistaken, is if there a different rate of return that's used in forecasting cash flows in a commercial damages case versus a valuation case.

Q. Actually, I didn't ask you about a rate of return. I asked you about a discount rate.

A. I apologize. I used those terms interchangeably.

Q. Okay.

A. The answer is, yes, as I testified

to in direct. The 18 percent number is an appropriate number in terms of the rate of return for the business. Whether or not that rate of return is appropriate in this case would depend on a fairly more lengthy analysis than was appropriate in this case. Since, as I mentioned, we determined there not to be damages.

But, in my experience and in practice, the point is to match the forecasting risks and the cash flows associated with that forecasting risk with the discount rate chosen.

As an example, if you're looking at a commercial damages case or a lost profits case that is resulting from a fire in a building where it took you 18 months to get the building back up and running, you had a certain occupancy rate and a certain proven stable cash flow, a discount rate of 6 or 7 percent might be appropriate because the forecasting risks are much, much different than they are in this case.

So the real point of the discount rate is you need to match the rate used with the

forecasting associated with the commercial damages case.

Q. Is one of the variables one of the factors taken into consideration market return in determining --

A. In determining the appropriate discount?

Q. Yes.

A. Market return is a factor in determining a rate of return for a book of business, yes. Expected returns.

Q. And the average market return according to your Claimant's Exhibit 11 is 4 percent?

A. Yes.

Q. Do you know what factor, well, do you know where Frank got his, the discount rate that he used?

A. I believe he testified it was a Treasury maturity rate; is that correct?

Q. Five-year rate?

A. I apologize. Yes.

You know, first of all, that discount rate is used in consistency over the

next five years in the forecasting period.

The rate of return that's appropriate in a forward-looking model and a commercial damages case of this nature is a forward-looking model, is an expected average market rate adjusted for additional risks, adjusted upwards or downwards for additional risks.

But the 4 percent return is the actual growth in his asset numbers over a 20-month period. Or 18-month period, I apologize. Whereas, a rate of return that should be used over the five-year forecasting period used by Mr. Marzano should reflect expected future returns in the market.

Q. If I can direct your attention to Claimant's Exhibit, I think it's Claimant's Exhibit -- beg your pardon -- Respondent's Exhibit 12.

Do you have a copy there?

A. Yes.

MR. GOOD: We actually just handed him one.

THE WITNESS: Just provided me one.

Q. If you can turn to the page numbered 3. It's in the lower right-hand corner that you're looking at.

MR. ZARETSKY: Mr. Chairman, page No. 3 was never admitted the panel may recall.

MR. CAMPBELL: No, no. I don't mean that. This one. The one with -- not that one, Mr. Petrie.

MR. MARZANO: Page 5.

MR. CAMPBELL: It's page 5.

THE CHAIRMAN: Mr. Campbell?

MR. MARZANO: Yes.

MR. CAMPBELL: That's the one. Frank's copy is out of order. I apologize.

Q. If you look at the box on the right-hand side, Mr. Dahl.

A. Yes.

Q. Isn't it correct that the calculation, the lost GDC per future year over a number of years, over five years, 462,798?

A. Right.

Q. That should mean no asset growth

beyond the numbers included in the box; isn't it?

A. That's correct. Going forward. But it assumes a significant asset growth during the period of time that was used to project to 9/05.

Q. It does that.

But we've already established that 2 million a month is the average during that period, right?

A. Yes. Although, I believe that 127 that's shown there would be a growth rate significantly higher than 2 million a month.

Q. Well --

MR. GOOD: Excuse me. The panel can't hear you. So you need to raise your voice and keep your voice up?

THE CHAIRMAN: Thank you.

MR. GOOD: Why don't you repeat your last statement.

THE WITNESS: I believe though, you mentioned the $2 million a month growth rate, if I'm not mistaken, the growth rate is significantly higher than $2 million a month during that 9/30/05

period in March of '04. I just want to clarify that point. You mentioned $2 million a month. And I'm not sure where that number comes from.

Q. Well, the 2 million a month comes from Claimant's Exhibit 11?

MR. MARZANO: 14.

Q. Claimant's Exhibit 14, your calculation of the adjusted change?

A. Sure. But it doesn't come from the exhibit where you calculate your present value where you use your discount rate.

Q. That's correct.

A. Okay.

Q. The question I asked you was, in fact, Frank's number $462,798 per year of lost GDC for five years, assumes no growth in assets above the 127,000,658?

A. That's true.

Q. So, how much you would grow, how much you would lose just assumes no change?

A. Right. Yes.

Q. Although you know that the testimony is that except for the events that

occurred in 2004, Frank's assets grew in a fairly consistent rate during the prior period that he was at American Express?

A. Yes. They did during the 14 months that Mr. Marzano showed.

Q. But, in fact, you looked at Claimant's Exhibit 14. It covers the months from 12/3/2002 onwards. But you are employed as an expert to do an analysis on behalf of American Express, right?

A. Right.

Q. So all of the data for 2002 was available to you if American Express wanted to make it available?

A. I suppose it would have, yes.

Q. Did you look at --

A. No.

Q. -- the asset growth in 2002?

And same would be true for 2001. The data's there. American Express has it?

A. But you didn't -- actually, I saw Mr. Marzano's testimony on asset growth. And I don't dispute it in any fashion.

Q. But you understand, Mr. Marzano

only has available to him a limited amount of data. And he didn't want to guess for the prior month for which he didn't have the data?

A. No, I wasn't aware of that at all.

Q. So he starts in December '02. And he testified because he had data from December '02 forward.

A. Right.

Q. American Express has the data for all of 2002. All of 2001 and all of, in fact, his entire career at American Express.

MR. GOOD: Let me just object to the characterization that whatever Mr. Marzano's testimony was. This gentleman wasn't here for his testimony. And while he may have reviewed his, at least part of his testimony, if not all of his testimony, he doesn't know what Mr. Marzano has or had in front of him. And, in fact, I would suggest to the panel none of us do. And the reason being we asked for that information. It wasn't provided to us. We asked for it in discovery at the time that he gave us a .

damage calculation.

MR. CAMPBELL: Mr. Chairman, this isn't an objection.

MR. GOOD: And now we don't have it. What Mr. Campbell can testify about, what he did or didn't have as he moved on, is inappropriate.

MR. CAMPBELL: Mr. Chairman, that comment was inappropriate. Frank testified at length where he got these numbers and why there's a gap here and why he started in December. And what we don't have, we cannot produce.

THE CHAIRMAN: Mr. Campbell, you can continue your questions.

MR. CAMPBELL: Thank you, Mr. Chairman.

Q. In fact, if you look at Exhibit 12, the trend analysis for assets under management page?

A. Yes.

Q. Which page is that?

A. This is page 4.

Q. Your page 4?

A. Yes.
Q. Frank's page 4, too. We're on the same page, at least, this time. There's a gap between December '02 and April '03.
We don't have January, February, or March on Frank's Exhibit 12, right?
A. Right.
Q. But you have used 40,000,354 for each of the months, December 2002 through --
A. Well, I believe that's in the same fashion --
Q. April?
A. -- as Mr. Marzano.
What I did was recreate his own inputs. It may not be shown on your graph. But it must have been there or you would have dramatically reduced your line by applying zeroes to those first three months.
Q. Or he could have added 2 million per month for each of those three months using his average, right?
A. That would have got him to a number lower than the April '03 46 million because I believe there was -- it would have gotten you to

about the same number. It's basically a linear relationship.
Q. Let me ask you a few more questions on Exhibit 12.
A. Is that page 4?
Q. No. Your Exhibit 14.
A. I'm sorry.
Q. Claimant's Exhibit 14.
A. Okay.
Q. I had a few questions about the second box there.
A. Okay.
Q. You've got clients' assets relying on saved assets. The last entry on the page.
A. Right.
Q. Where did you get that number?
A. American Express provided a spreadsheet with a number of boxes that were corresponding to a questionnaire that's provided when the client -- I believe it's when the client first initiates or first opens their account. And one of the clients on the box is, you know, specific to primary sources of income. And what I did, the spreadsheet showed each of

the answers from these questions. And what I did was highlight the questions where they were primarily relying on it. Saved assets. And some of those totals.
Q. That's a summary exhibit that American Express provided you. It's not data that you went back to the original client responses and gathered for yourself?
A. No. They provided me a blank client response form and then the input data.
Q. Do you know how many of the clients responded with that information from among the 253 clients, roughly, in total?
A. It's my recollection as I sit here that 100 percent of the boxes were filled out on the spreadsheet as provided.
Q. Well, that spreadsheet wouldn't tell you what assets they're saying they're relying on; would it?
A. No. Just simply, it refers to saved assets investment income. It's a primary source of income.
Q. But you had the statements for all of Frank's clients available to you?

A. Yes.
Q. For the period in question?
A. Right.
Q. Did you attempt to determine from those statements what the monthly average withdrawal rate was?
A. No. I didn't have the statements on month-by-month history. Statements as of March 2004 that I've reviewed.
Q. Oh. You didn't look at any of the statements for 2002, 2003, or 2004?
A. For the clients? No.
Q. So you don't know what the actual withdrawal rate was?
A. No.
Q. So you couldn't correlate the number of clients or the total assets for the clients who said check the box or allegedly check the box saying that they were relying on saved assets?
You couldn't correlate that with what the actual withdrawals were?
A. No.
MR. CAMPBELL: One minute, Mr.

Chairman.

THE CHAIRMAN: Sure.

Q. Now, you also testified that the asset types, the percentage of fixed income versus equities was almost exactly 60-40?

A. Yes. Very, very close.

Q. How did you come to that number?

A. We looked at the statements as of March '04 for each of the clients on Frank Marzano's client list. We broke out the equity mutual funds and equity from fixed income products, including fixed income, mutual funds, bonds and annuities and money market funds. And then the sum of those totals over the total of the accounts represents the 60-40 split.

Q. Yes.

So if we look at Claimant's 14, the box at the bottom where it's got equity, mutual funds/stock, you got 60.3 percent?

A. Right.

Q. And if we look at, so you just took that as a gross number?

A. That is the total number from the

statements, yes.

Q. Did you do a Morningstar analysis at the mutual funds in question that the clients had their money invested in?

A. No, no. They were all reflected on the statements as equity mutual funds. We went no deeper.

Q. Are you aware that in some cases what's designated an equity mutual fund may, in fact, have some portion of the assets invested in cash?

A. Yes.

Q. And some portion of the assets invested in bonds?

A. Yes.

Q. So that if you looked at what the actual assets/holdings were, you'd get a clearer picture. There would be some?

A. That's partly the reason why we left the annuities in the fixed income products. We knew it was an offset.

Q. Explain what you mean by that.

A. Sure. The annuities which variable annuities have an equity component to them were

not included. We did not break out the equity component of the annuity product. We left them as fixed income product and left all the mutual funds with mutual funds products.

Remember, the equity mutual funds to be termed equity mutual funds, I would assume would require a preponderance of their assets be invested in the equity markets even though admittedly there would be a small, or smallish component of those assets that are fixed income and product.

Q. For example, preferred stocks would be considered an equity, even though they're more like a fixed income product?

A. I agree that they're more like a fixed income product. As I sit here today, I can't testify as to how they're treated in an equity mutual fund.

Q. You could have done a Morningstar analysis and got a breakdown within each mutual fund what proportion was actually in equities?

A. For each.

Q. Including annuities in Morningstar?

A. It would have been possible to do

that. It would have been possible to do that.

Q. But you didn't do it?

A. No.

Q. With respect to 2002, you know what the market performance was in 2002?

A. Not off the top of my head. No. I note that there is -- well, actually, I take that back. I was going to say there was a couple of data points. I know that from December 2002 to March of 2003, data is there. But between January and December 2002, no.

Q. You're not aware that the market was down about 28 percent in 2002 for the year?

A. As I sit here today, I could not verify or confirm that number. And I would just note some of the testimony about rate of returns over the historical period of time have been somewhat questionable. So I would caution you to go back and look, at least enter into evidence any suggestion that that was a rate of return to be sure we're all talking about the same rates.

Q. You're saying you don't know?

A. No.

Q. What the market rate of return was

in calendar?

A. No.

Q. 2002?

A. Not as I sit here.

Q. If you assume it was down 28 percent, it's a hypothetical question now since we don't have a real number, and if Frank's assets were up significantly during that period of time, would that have significantly, and if you inputted those numbers into your analysis, would that have significantly changed the outcome?

MR. GOOD: Let me object to the form of the question. It puts facts not in evidence and outside the scope of what this individual was working on and looking at. If that was information that Mr. Marzano or Mr. Campbell thought would be significant, then that's information they should have made available to us. They didn't. It's not information they have here, short of this assumption and hypothesis, has no real basis. We don't know whether it's real or not.

MR. CAMPBELL: Mr. Chairman, it's perfectly appropriate to ask an expert witness to change the numbers and tell us whether or not, in his opinion, those changed assumptions would change the outcome.

Whether or not they are significant, the answers are significant, of course is up to the panel to determine. But certainly it's appropriate to ask an expert witness a hypothetical question, did you take this into consideration, no. If you did, would that change that outcome. Answer, yes or no. That's not beyond the scope of the evidence. That is just a question as to whether or not different assumptions would lead to different results. And the panel can determine for itself whether or not these assumptions he was asked to take into consideration are assumptions that you have or will hear before the end of the testimony.

MR. GOOD: That's exactly the

reason why it's inappropriate. Because Mr. Campbell is asking this panel now to bootstrap information that is not in evidence and he has no support for. And is asking you to take it, not only as fact, but asking you to take it for the truth of the matter asserted. And therefore, it's inappropriate.

MR. CAMPBELL: Mr. Chairman --

THE CHAIRMAN: Mr. Campbell, I'm going to let you continue.

THE WITNESS: I think the appropriate way to answer that question is that it certainly points out the need for a proper regression analysis to consider an extended period of time and a full business cycle.

And it further indicates the problems that we definitely have with the 14-month regression. The implications for the model are as written; that the asset under management growth Mr. Marzano had is fully and completely as a result of new business.

But, again, as I stated before, this regression model, even as improved in the new version with the two variables, is still an inconsistent and an incomplete way of looking at assets under management.

Q. So the answer is, yes, in fact, it would significantly change the outcome if all of the increase in assets attributable to Mr. Marzano in 2002 came from new business?

MR. GOOD: Objection.

Q. Is that correct?

MR. GOOD: That's not this witness' answer. That's Mr. Campbell's answer. So I move to strike Mr. Campbell's comments.

MR. CAMPBELL: It wasn't a comment. It was a question.

THE CHAIRMAN: The objection is sustained to the question.

Q. Yes or no; if the market was down 28 percent and Mr. Marzano's assets were up significantly in 2002, would it change the outcome significantly?

A. Yes.
MR. CAMPBELL: Thank you. That's all I wanted, Mr. Chairman.
Q. And, of course, as you asserted, the more data you have, the better --
A. Yes.
Q. -- your result.
And the numbers for 2002 for Mr. Marzano, clients' assets under management total return, all available to American Express, right?
A. I can only presume so.
Q. Now, Mr. Marzano testified that by approximately --
ARBITRATOR COHEN: Go ahead, Mr. Campbell.
Q. The testimony from Mr. Marzano was that by about November or December of 2004 he had over, basically all of the assets that were coming over from American Express, approximately $59 million by the end of November, certainly by December of 2004. And, as you know, because you've reviewed the testimony, his testimony is that he has approximately 93 million, $94

million by what, the end of September of 2005?
A. Right.
Q. Which is a 34-$35 million increase between December '04 and October '05.
What has the market performed in that period?
A. The market has been sideways during that period.
Q. Sideways?
A. Yes. Best characterized that way.
Q. Does it look like, what, the bulk of that increase will be new money? It would have to be.
A. I have no way of making a basis. Just looking at the Standard & Poor's 500 between 12/31/04 and 10/30 just to confirm, it was very much sideways.
Q. But if Frank were accumulating at new assets of approximately 2 million a month in that time period, he would have added what, $18 million?
A. Hmm-hmm.
Q. Is that right?
A. Yes.

Q. Because he did better than that too; didn't he?
A. I'm relying on the numbers you gave me that that sounds right, yes.
Q. He was up 35 million, difference between 94 and 59?
A. Okay.
Q. Do you agree, in the context of valuing a practice, that there's a difference between a mature practice, value a practice for purposes of determining how it might perform going into the future, there's a difference between a mature practice where the advisor has accumulated assets, built a practice basically to the point where he can't grow any more without adding a lot more new people and he's living off of the assets that he's already got, not adding significantly every year, and a practice that is in that growth asset gathering stage where he's still building up to the plateau where he will find it hard to add new assets and service the assets he's already got?
A. Yes.
Q. And you agree that Frank has a

fairly new practice?
A. Yes.
Q. Four, five years old.
And he was in that asset-gathering, growing stage; wasn't he?
A. It appears that way. Yes.
Q. If you value the future projected growth of the second type of practice, it's going to come to a much higher projected number than the projected future growth of the first kind of practice that is mature, and basically ticking over with little added new --
A. Yes, it was. The biggest issue is that forecasting growth rates for the two practices is a different process, in that there are many other factors, many factors that you consider in the mature business that you wouldn't consider in the growth business, and vice versa. And this is particularly pertinent when looking at historical data to develop trend analysis without consideration of factors going forward.
Q. In the case of Frank, or, as we said, you had more data available, American

Express had more data available to it as far as historical trend is concerned than Frank did, but as to going forward, we all have the same data as for the period March 2004 to November-December of 2005, right?
A. Right.
Q. Because that's already occurred?
A. Right.
Q. It's no longer projection, it's historical. And so the information we're looking at just now, the 59 million in December of 2004 versus 93 million by October 2005 is not projection. That's actual growth during the period of time?
A. I don't believe those numbers are in dispute, no. I don't believe I've seen any numbers though, personally, other than the February '04 number and the September-October '05 number.
Q. So you don't know what happened in each of the months in between?
A. Right, right.
Q. Let me just do a couple of background questions while Frank figures out

some other ones for me to ask on a more technical basis.
Can you tell us what proportion of your valuation business, going back to your resume now, what proportion of it is AEFA related?
ARBITRATOR COHEN: Is what related?
MR. CAMPBELL: AEFA related.
A. American Express related? I have personally valued three American Express Financial Advisor practices in the last four years.
Q. So a small proportion is American Express related?
A. Yes.
Q. How about the litigation support part of your business. I think you said one-third of your practice is litigation support.
What proportion of that is American Express related?
A. This is the first time I've ever testified on behalf of American Express.
Q. Okay, good.

How about your firm though. Does your firm do more than you do personally?
A. Yes. We do some compensation consulting work and other consulting work. As I sit here, I have no idea whether anybody at Moss Adams has ever testified on behalf of American Express other than myself. I can tell you that as of the point in time we were contacted by American Express, we had no active engagements. Because as is common practice, we have to do a conflicts check.
Q. How much are you being paid here to appear here?
A. $245 per hour.
Q. If I can direct your attention to Claimant's Exhibit 11 again, the box at the bottom of the page.
A. Yes.
Q. The assets in dispute as you labeled it.
A. Hmm-hmm.
Q. The number there, the 3.902 million number.
A. Right.

Q. Does that include nonproprietary B shares?
A. I believe it does not. It does not. It absolutely does not. I apologize for the uncertainty. It includes annuities and AEFA B shares.
Q. AEFA B shares and annuities?
A. Right.
Q. And could it include assets that have transferred over to Frank?
A. No. Those are, none of those assets transferred over to Frank. Those are all assets that are on the March 2005 financial statements for AEFA.
Q. March?
A. Sorry. September 2005.
Q. September 2005 statements for all of the clients that still have assets at AEFA?
A. Right.
Q. Are you saying you went through each of the statements and had added them up separately?
A. That's right. Yes.

Q. You didn't look at any summary from American Express?
A. No.
Q. Didn't look at the scorecard or anything like that?
A. No.
Q. Where is the exhibit that gives the performances? Claimant's Exhibit 11.
A. Yes.
Q. Where it says organic growth in assets.
A. Right.
Q. Where you come up with an average rate of 26.1, in fact, if the weighting equity versus fixed income were 50-50, would that significantly change the average number in the right hand of that column?
A. It would.
Q. Left-hand column of that box, I mean?
A. If it were 50-50, the rate would go from 26.1 to 22.7. I don't know if that's significant. But that's the change.

Q. Thank you.
The bottom box, the assets in dispute box of Claimant's 11, were you given the client names there?
A. Yes.
Q. You did not make any specific determination that any of these clients, in fact, said they weren't going to come over?
A. No, I didn't.
THE CHAIRMAN: Mr. Campbell, I'm having trouble hearing.
MR. CAMPBELL: What I asked, Mr. Chairman, did the witness specifically determine whether any of those clients said they weren't going to come over, or were they just given the names to include?
THE WITNESS: Counsel represented to myself that those were names that have been or will be entered into evidence. That's the box called assets in dispute.
Q. Now, about commission splits, you testified a little bit about commission splits.
What data did you review to

determine what proportion of Frank's GDC encompassed in commission splits?
A. I might have testified to this. If not, I apologize, I didn't review it all. The comment is more specific to market evidence which is that asset growth rate of the type that's being described would normally expect to see more than a single advisor's sharing in the gross dealer commissions.
If, historically, Mr. Marzano's practice had been growing as rapidly as it obviously has been, the percentage of GDC that effectively Mr. Marzano keeps as the sole account rep is going to change as the asset risks increases.
And it's possible we didn't review any data. But it's possible and probable based on market data that that GDC number should be reviewed in light of the need to add new reps who are also earning on a commission basis.
Q. So his expenses for managing that practice would go up you would expect?
A. It is possible. And, yes, I would expect.

Q. But you don't know whether or not, in fact, Frank couldn't handle a bigger client base?
A. No. The comment is entirely based on market evidence.
Q. Is it your understanding that Frank Marzano's practice was a transactional practice, generating GDC via trading and other transactions?
A. No. I was not aware of that. And didn't review any data that would suggest so.
Q. Do you know how he generates his income, the GDC number at American Express?
A. In terms of tracking new clients and investing money for?
Q. Are you aware that 80-plus percent of Frank's income comes from asset management fees, financial advisory fees?
MR. GOOD: Objection, objection.
THE CHAIRMAN: Do you know?
A. Yes, yes. I apologize. Yes.
ARBITRATOR COHEN: That number was what, Mr. Campbell, what percentage you used.

MR. CAMPBELL: Frank's telling me I used the number -- it was probably too high.
Q. At the time he left American Express, do you know what proportion of Frank's GDC number at American Express was from financial advisor fees?
A. Now that I understand the question, I actually have to withdraw my last comment.
No, I wasn't aware of the percentage in any regard as to split between fees and --
Q. Transactions?
A. Transactions fees.
Q. Do you agree, based on your experience in dealing with financial, valuing practices, that a planner, an advisor who generates a majority of his income from advisory fees rather than transactions can manage, in fact, a bigger client base?
A. There's truth to what you said. But I will say this: The data that we looked at to compare Mr. Marzano was a select set of the overall database that would support, that would

include a higher percentage of people in the same boat, if you will. The comparison isn't to the broad index of average financial planners, but to that specialized set of financial planners that are particularly, primarily comparable to Mr. Marzano.
Q. You mean in how they generate and what proportion of their fees will be generated from advisory rather than transaction?
A. That's right. Yes.
Q. Not specifically to Mr. Marzano's actual capacities?
A. No.
Q. In fact, did you get from American Express, Mr. Marzano's actual GDC under his advisor number for each year?
A. No. I took Mr. Marzano's data verbatim.
Q. You know that how the reporting system works though, right?
So that if Mr. Marzano shows an actual of 2003, I think it's in Exhibit 12, page 1, that's the GDC analysis.
A. Right.

Q. If he shows for 2003, 718,000, that is the actual amount paid to him. So if he was getting a 50 percent split on some of his business that includes 50 percent, doesn't include 100 percent?
MR. GOOD: Objection. What's the basis?
MR. CAMPBELL: I asked him if he knows how the reporting system works.
A. Yes, I do.
Q. Right.
And if he got 780,000 GDC, some of that is made up of 100 percent, some of it's made up of whatever the commission split was. It's just what Frank was paid?
A. Yes.
MR. CAMPBELL: Thank you.
MR. GOOD: I object to that. We don't know that because we haven't been provided with that documentation that we asked for over and over and over again.
Move to strike.
MR. CAMPBELL: Mr. Good, of course, goes too far. We are talking

about the American Express numbers, what American Express paid Frank. Numbers that American Express has had, always has, and are reflected in the 1099s given to Frank by American Express.
MR. GOOD: That's not the point. His damage calculation --
THE CHAIRMAN: Next question, Mr. Campbell.
MR. CAMPBELL: Now, Mr. Chairman, I just want to take a minute to go through my notes.
THE CHAIRMAN: Sure.
Mr. Campbell, are you going to need a few minutes? You want to take a short break?
MR. CAMPBELL: I'm going to try to finish now, Mr. Chairman. I don't think it will take very long.
Q. You made a comment, Mr. Dahl, about I think you said a 5 percent attrition rate, an average 5 percent attrition rate when advisors moved broker-dealers?
A. Right.

Q. Was I right in my understanding that you were not saying that that was only the attrition rate for any particular reason, that the overall attrition rate --

A. That's right.

Q. So some of that attrition rate is attributable to assets that couldn't move. Some is attributable to other reasons?

A. Yes. There's no breakdown of the reasons.

Q. Do you know what the attrition rate was you calculated from the data that you've had made available to you?

Is it what Frank's attrition rate was?

A. On a percentage basis? No. I know it was roughly 17 million, or at least -- actually, I misspoke. I believe it's 18 million in assets that did not come over.

Q. From the 79 million leading to approximately what, 23 percent, 24 percent?

A. I believe that's from the 70.2 million.

Q. You said that the delays in

contacting clients would have a negative, would have an adverse impact on the ability to move assets?

A. Actually, I believe Mr. Marzano said that in testimony.

Q. I think, and your testimony was you agreed?

A. Right. Yes.

Q. And it's based on your experience overall; is that right?

A. Yes. And also on my experiences in the professional and financial services industry. And my experience when I don't contact clients.

Q. And, for example, if an advisor were to move from one broker-dealer to another and didn't have any of the files relating to the clients that he serviced at the first broker-dealer, you think that that would adversely impact his ability to re-establish the business at the new broker-dealer?

MR. GOOD: Objection. Question of files doesn't necessarily mean that an individual can't be contacted.

MR. CAMPBELL: Objection, Mr. Chairman. Now he's trying to educate the witness.

THE CHAIRMAN: Okay, gentlemen. You want me to send the witness out?

MR. CAMPBELL: I think we should stop right there, Mr. Chairman. If that's the objection, I say that's not an objection. That's just a comment.

THE CHAIRMAN: Overruled.

Answer the question if you can, Mr. Dahl.

A. Can I ask for a clarification?

When we're talking about files, what are we specifically talking about?

Q. The client file. Everything in the client file.

A. Does that include all the contact information, electronic records, your Rolodex, and everything else?

Q. Name and telephone number. Let's assume he has the name and telephone number. Doesn't have anything else.

A. Does the client have their

statements?

I'm trying to get some information. It's something I haven't thought about.

Q. Maybe they do; maybe they don't.

It would matter if the client had to wait until the next month to get a statement. And then the advisor tried to get a copy of the statement from the client. That would matter; wouldn't it? Because it extends the period of time during which the assets don't transfer?

A. You said maybe they do; maybe they don't.

Do the clients have a current statement?

Q. That's what I'm saying: Maybe they do; maybe they don't. Some clients keep them; some clients don't. Some clients rely on their advisor to keep those records for them.

MR. GOOD: Objection.

Q. Isn't that right?

A. I'm not sure I know that answer to that question.

MR. CAMPBELL: I think the lawyer educated you very well and focused the

clarifications.

MR. GOOD: Objection.

THE CHAIRMAN: Strike the last comment.

MR. GOOD: Thank you.

Q. In making your determination, valuing a practice in the context of a planner's moving from one broker-dealer to another, would it make a difference, would it have significantly impacted your valuation of the business if the planner involved, the planner who's making the move had a restrictive covenant?

A. A restrictive covenant is an asset of the business. The value of such restricted covenant has always been in doubt. It's something we don't place a great deal of emphasis on truthfully when we're valuing practices because the enforceability of such covenants is an issue. There are a lot of issues outside the valuation.

And, frankly, the personal choice of the individual client is an issue. So to the extent the restrictive covenant is there, it's

not something that's generally weighted significantly in valuing a practice. When we value them for purposes of allocating asset value between asset classes on a balance sheet, it's the last thing we allocate value to. And it's limited to a small percentage of the overall value.

Q. Are you saying that if you have a practice that involves a restrictive covenant on the person who's moving from one broker-dealer to another. And let's assume for purposes of the question that the restrictive covenant is enforceable and is going to be enforced. And you have the same practice, only there's no restrictive covenant at all. In fact, there's the opposite; there's a piece of paper saying that the clients belong to the advisor and the advisor can do whatever he wants. He can move all the assets without interference if he wants, if he leaves.

Are you saying that the practice will be valued the same in both cases?

MR. GOOD: Objection. Again, it

assumes facts not in evidence. And Mr. Campbell is providing a commentary about something that --

MR. CAMPBELL: Objection, Mr. Chairman.

THE CHAIRMAN: Mr. Campbell, could we have --

MR. CAMPBELL: I want the witness out of the room this time.

THE CHAIRMAN: That's a different question. Mr. Dahl, can you step outside please.

MR. CAMPBELL: Thank you, Mr. Dahl. I apologize. (Wherepuon, the witness left the hearing room.)

MR. CAMPBELL: It's a purely hypothetical question, Mr. Chairman.

THE CHAIRMAN: Let Mr. Good finish, please.

MR. GOOD: It is a hypothetical question. But, again, he's attempting to bootstrap information in putting facts that don't correlate to this case. He's

characterizing what he thinks a document says. It's not what the document says that may or may not be at issue in this case. And he's given it a spin to something.

If he wants to correlate it to this case, then let him use the language that's in this case. If he's not, then he's putting facts that are not in evidence. It's irrelevant. And it's beyond the scope of appropriate examination of this witness.

MR. CAMPBELL: Mr. Chairman, that was really kind of closing, his own commentary on what is in evidence. The reality is that if you don't believe the hypothetical is very relevant, then you will just discount it. And I know that and he knows that.

If I say assume American Express is going to pay Frank and help him to carry the boxes over to his new firm, and that is something you know isn't in evidence, then of course you discount the whole

question.

It is perfectly appropriate for me to ask a hypothetical question that I will later argue to you incorporates evidence that you have heard or that has been placed before you in support of Mr. Marzano's claim.

It's not appropriate for him to say, oh, Tom, you can't say that because that part isn't proved. That's for you to decide; not for Mr. Good to decide or for me. I develop the hypothetical. If I go too far the panel will know that I'm into an area of fantasy or will just discount the answer. It's not a valid objection to a hypothetical question. It's a valid objection to what conclusions you can draw. But that's for both sides to argue to you.

MR. GOOD: Well, it is a valid objection. Because again, he's creating facts that he's attempting to bootstrap and argue. And he's using it as a basis for use in closing argument within this

matter. And he's trying to pick up a nugget of information or something that has no real bearing to what this case is.

And if he wants to put a hypothetical in front of the individual, have him use the document. Otherwise, if he's not doing that, he's just creating something that he's trying to bootstrap and use in order to change the scope and the focus of this. And that is closing argument. He can argue that.

MR. CAMPBELL: Mr. Chairman, obviously this is not a fact witness. I'm not using him to put in any facts. Hypothetical is hypothetical. It doesn't make any sense to argue that I'm trying to put in a fact through this witness. And then I'll argue to you that that is the fact that we should rely on. I'm just getting a copy of the exhibits for my next question.

THE CHAIRMAN: We're going to overrule the objection. And I'll go get the witness.

MR. CAMPBELL: Thank you, Mr. Chairman.

THE CHAIRMAN: Continue.

(Question read.)

A. If you indulge me, I want to answer that in two parts.

Part number 1 is, no, I'm not saying that. I have, in fact, said there is value in a restrictive covenant. Second part of the question is that more prescient than the restrictive covenant is the client's personal choices. And that clients, even in light of a restrictive covenant, choose for personal reasons to leave or stay.

Q. Are you saying that in your -- with respect to files, I asked you about it earlier, are you saying that it is irrelevant whether or not the advisor is able to have copies of the files when he moves from one broker-dealer to another it's irrelevant to his ability to transfer the assets to reduce that attrition rate, so the 5 percent average --

A. I don't think I said it's

irrelevant. I said there's a lot of important information, particularly affecting your ability to contact your client base.

The statement issue I would have to ponder how long are you without statements. What statements are you talking about. What file data are you particularly concerned about.

I'm not sure that I'm necessarily qualified to sit here and answer those questions.

Q. So the longer it takes you to reassemle the data you need from the files, the more adverse impact you would suffer; is that what you're saying?

Less time, the less adverse impact; the more time, the more adverse impact?

A. Again, the statement is certainly outside of my area of expertise as a financial expert, as a financial testifying expert.

MR. CAMPBELL: Mr. Chairman, I think I'm finished. Maybe we can just take that one-minute break. And then I'll confirm that I'm finished.

THE CHAIRMAN: How about five

minutes.

(Short recess.)

THE CHAIRMAN: Back on the record. Mr. Campbell.

MR. CAMPBELL: No further questions, Mr. Chairman.

THE CHAIRMAN: Mr. Good.

MR. GOOD: I have nothing further.

THE CHAIRMAN: Okay.

ARBITRATOR PETRIE: I have some.

THE CHAIRMAN: The panel has a few questions for you.

ARBITRATOR COHEN: Just for clarification.

THE CHAIRMAN: Mr. Cohen will start.

ARBITRATOR COHEN: First of all, Mr. Dahl, thank you for for coming in again.

THE WITNESS: Glad to be here.

ARBITRATOR COHEN: Twice I heard the term attrition rate at 5 percent.

THE WITNESS: Right.

ARBITRATOR COHEN: Are we referring

to how much business is lost in a transition?

THE WITNESS: Well --

ARBITRATOR COHEN: According to your study?

THE WITNESS: According to a study that's published, actually not by Moss Adams but by a company called FP Transition, the effect of changing of the broker-dealers has the impact of losing 5 percent of a book of business.

ARBITRATOR COHEN: The reason I ask is, that in my limited experience with it, I would have anticipated and I believe that the rate for account representatives in brokerage firms is considerably more.

Does this study include all account executives, all registered personnel, or is this limited to broker-dealer people?

THE WITNESS: You know, as I sit here I can't recall. The data is presented in terms of assets. And it's one of the issues we always had with FP

Transitions and their data sources, is that they're not as complete as you probably would like in terms of the explanation.

But I did read the study. And the way the study is presented is the implications on a financial advisor's practice of changing affiliation is the term that they use. And they present a number that in the first three months you can expect a 5 percent decline.

ARBITRATOR COHEN: Thank you, Mr. Petrie.

ARBITRATOR PETRIE: Mr. Dahl, on Claimant's 14 I just want to clarify one thing.

We have an adjusted change month by month.

THE WITNESS: Yes.

ARBITRATOR PETRIE: The first, one line shows an adjusted change of $4.4 million. That's to a three-month number.

THE WITNESS: That's correct.

ARBITRATOR PETRIE: So when you

calculated the 2 million 14 down at the bottom of that column, did you weight it as three months or one month.

THE WITNESS: I did not.

ARBITRATOR PETRIE: What would be the effect of that?

THE WITNESS: It actually inflates the $2 million number because you get all of that growth. Actually, the 5.9 million is a four-month growth number. If we had the months we would have calculated properly. It would have brought the average increase and average assets down, probably down below the 2 million number that's shown there.

ARBITRATOR PETRIE: In other words, if correctly calculated, this number would be a little smaller, the monthly additional per assets.

THE WITNESS: Yes.

ARBITRATOR PETRIE: On that same exhibit, assets under management analysis, the second box.

THE WITNESS: Yes.

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ARBITRATOR PETRIE: We heard what you said about working from small data sets. And I'm wondering whether we should give much weight at all to the third and fourth columns of numbers here. September 2000, 5 percent of total. Other than to observe that for the numbers down at the bottom, bottom two rows, client assets greater than 60 years old and clients' assets relying on saved assets, that what this data would suggest is that from an aggregate mix as of March 2004, 5 percent of a client block to clients over the age of 60, if a greater percentage of that remained at American Express, then for the average to work out, some smaller percentage would have gone to the new asset base, right?

THE WITNESS: Well --

ARBITRATOR PETRIE: Would have transferred to MultiFinancial.

THE WITNESS: I applaud you. You lost me.

ARBITRATOR PETRIE: You think the

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question was too convoluted. If we went from 23 to 31 percent.

THE WITNESS: Yes.

ARBITRATOR PETRIE: Doesn't that imply that for the assets that did transfer, that the clients over the age 60 would be something under 25?

THE WITNESS: I think what it implies, and maybe we're saying it in a different way, I think what it implies that there was a greater number of clients over the age of 60 who kept their assets in American Express.

ARBITRATOR PETRIE: Right.

THE WITNESS: Financial advisors.

ARBITRATOR PETRIE: And the flip side of that is that the assets that did move, we have a greater proportion of clients who are under --

THE WITNESS: Younger assets. I think that's correct.

Just to clarify your comment about the inappropriateness perhaps of the asset mix data, the fixed asset money

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market fund.

ARBITRATOR PETRIE: I haven't gotten to that comment yet. I'm going to. But I haven't asked you that question yet.

THE WITNESS: Go right ahead.

What was your first comment though so that I understand it?

ARBITRATOR PETRIE: You told us that looking at a small data set we can value the regression analysis and refer to the fact that you had 14 data points, or Mr. Marzano provided 14 data points going into this regression.

THE WITNESS: Right.

ARBITRATOR PETRIE: And I noted that what we're comparing here is $70 million as of March 2004 versus 18 as of March 2005.

So, I would assume, unless you tell me I'm wrong, that the March 2004 numbers are more representative.

THE WITNESS: I see what you mean. Of the total aggregate?

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ARBITRATOR PETRIE: Yes.

THE WITNESS: Yes. That would reflect a client base, Mr. Marzano's client base on a better basis, for sure. I think the only comparison that between March and September are those comparative numbers that you suggested previously. I think the higher fixed asset annuity number as a percentage of total assets is reflective of those locked up assets that didn't come over as well.

So they are sort of comparisons between the two points that point to some of the things that we experienced or witnessed in the data itself.

ARBITRATOR PETRIE: Okay. Well, that leads us directly into the asset allocation question.

THE WITNESS: Sure.

ARBITRATOR PETRIE: We talked about the mix being approximately 60 percent equity, 40 percent fixed. And we see from this data that, okay, that that seems plausible. Maybe 50 to 60 percent

equity, obviously subject to the issues we've talked about earlier: That is, an equity fund might have some fixed in it but a variable annuity might have some equity in it.

So there's a certain amount of noise in that data. But something on the order of half or a little more of the assets appear to be equity. And something on the order of half or a little less than the equities appear to be fixed?

THE WITNESS: Right.

ARBITRATOR PETRIE: When you recap the regression analysis on Claimant's 14 you used equity variable as an additional variable, but not fixed income returns.

THE WITNESS: Yes.

ARBITRATOR PETRIE: Why?

THE WITNESS: The correlation is the only thing that matters in the regression analysis, not the actual returns.

In other words, we weren't dollar-

for-dollar reducing the inputs. We were simply measuring the relationship between its change in assets and the change in the stock market.

If the relationship is -- excuse me -- from the asset mix was zero fixed income. For example, zero equity, 100 percent fixed income for example. Then there would be no or very little correlation in the S&P 500.

The correlation analysis or measurement captures the differential between the actual assets and the actual assets allocation, and the way they respond to the Standard & Poor's 500. Similar fashion how you measure the correlation between Standard & Poor's 500 and a mutual fund that was mixed in terms of asset base.

ARBITRATOR PETRIE: I understand.

THE WITNESS: Okay.

ARBITRATOR PETRIE: Maybe I didn't make my question quite clear.

Let me phrase it this way: You've

added the original regression analysis that Mr. Marzano presented used only date as its independent variable. And you suggested that we should add the S&P 500 and another independent variable and prove the r-squared subject to we still only have 14 data points going in. So that we know that r-squared is of limited value, subject to the data set.

What would the conclusions have been had you put in the S&P as an aggregate index?

THE WITNESS: Now I understand.

ARBITRATOR PETRIE: Because again, the asset mix is certainly not predominantly either equity or fixed. It is somewhere in between.

THE WITNESS: Right. It would have had very, very little impact on the data because the data set, because the fixed income over that period of time is virtually flat. Very, very small changes in the fixed income data.

I believe it's Exhibit 11 indicates

the annual growth rates, especially since 2004, have been about flat. 0.2 percent. The growth rates between February of '04-February '05 were about 1 percent. And growth rates prior to '04 were about 5.3 percent during the regression period.

So to the extent there was an impact, it would have been very muted in my opinion.

ARBITRATOR PETRIE: Now, I'm a little confused. Because we clearly have an upward trend in these numbers. So if we put in another intermittent variable that's flat, isn't that going to have an effect?

THE WITNESS: Muted. As again because what you have is a growth in assets that is not correlated or very marginally correlated with the change in the Lehman Index or the Dow Jones Corporate Bond Index.

And, obviously, I didn't run the calculations. So that is an opinion. But I believe what you would see is that

the analysis itself wouldn't change materially, or not significantly at the very least.

ARBITRATOR PETRIE: It says on Exhibit C-13 that there was knowledge of correlation, which is not a surprise, given that independent variabiles are market prices and time.

THE WITNESS: That's right.

ARBITRATOR PETRIE: I notice that we didn't put in an adjustment for that. We didn't put in any variables or any adjustments that might be appropriate for another correlated independent series.

THE WITNESS: Right.

ARBITRATOR PETRIE: The question is, would it matter?

And, in particular, I'm concerned about the fact that we've made a big point of for the period of time that we have actual assets under management numbers, the growth rate in the markets with the 60-40 mix was 26 percent. And for the period that we're trying to

project, it's 4 percent.

So with such a dramatic change in at least one of the independent variables here, does the fact that we haven't done anything about the other correlation significantly affect the result?

THE WITNESS: I think it does. And I think it goes further to show why a regression analysis was probably the wrong approach to be taken in the first place.

ARBITRATOR PETRIE: What effect would that have on your conclusion?

Numerically, can you estimate?

THE WITNESS: I can't. I apologize. As I sit here I could not estimate it. It would be at a 95 percent confidence would know that it's significant. Whether it's a 10 percent impact or 5 percent impact, I don't know.

ARBITRATOR PETRIE: But would you sitting here today be able to tell us whether it would make your result higher or lower?

THE WITNESS: It would -- the outcome?

ARBITRATOR PETRIE: Yes, the outcome.

THE WITNESS: The outcome would be -- let me think about that for a second, if I may.

ARBITRATOR PETRIE: Okay.

THE WITNESS: It would make it lower. It's probably on the magnitude of 9 percent, 10. Maybe 15 percent.

ARBITRATOR PETRIE: So your projected assets under management had you taken into account the other correlation, it would be lower. And now you're thinking 9, 10, 15 percent?

THE WITNESS: About 15 percent, right.

ARBITRATOR PETRIE: I see that under the box multiple regression equation, we've got standard errors as well as the coefficients for the data in the S&P. And those standard errors are pretty large as a portion of the

coefficient. In particular for date, standard errors, 8 versus a coefficient of 29 and the S&P standard errors, roughly, 11 versus coefficient of 63.

How much noise? So we've got some noise in the coefficients. Again, not a surprise, given the small data set. But that's what we have?

THE WITNESS: Right.

ARBITRATOR PETRIE: How much noise should we anticipate that would cause in the quality of the projected assets resulted from your regression?

THE WITNESS: I couldn't testify to that as I sit here. I'm not sure how much noise on a combined basis.

The one thing that I would suggest, though, is that the statistic as high as it is suggests that there's significant statistical significance, if you will, in the data outcomes. That's about as far as I can go to answering your question though.

ARBITRATOR PETRIE: So the large